he Indonesian Quarterly

Third Quarter 2011 Vol. 39 No. 3

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Centre for Strategic and International Studies

The Indonesian Quarterly
Third Quarter 2011
Vol. 39, No. 3

The Indonesian Quarterly is a journal of policy oriented studies published by the Centre for Strategic and International Studies (CSIS), The Jakarta Post Building 3rd Floor, Jalan Palmerah Barat No. 142-143, Jakarta 10270, Indonesia. It is a medium for research findings, evaluations and views of scholars, statesmen and thinkers on the Indonesian situation and its problems. It is also a medium for Indonesian views on regional and global problems. The opinions expressed in *The Indonesian Quarterly* are those of their authors and do not necessarily reflect the opinion of the CSIS.

The Logo

To better represent the underlying ideas that gave birth to CSIS in 1971, the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, was designed by Indonesia's renowned sculptor G. Sidharta and comprises a disc with an engraving of the globe, which serves as a backdrop to a youth with an open book on a cloth draped across his lap, his left hand pointing into the book, and his right raised upwards. All these elements combine to project the Centre's nature as an institution, where people think, learn and share their knowledge. Mankind is their concern and the world their horizon. The undressed torso symbolises open-mindedness and the absence of prejudice in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "Nalar Ajar Terusan Budi", in the Javanese language, conveys the Centre's belief that "to think and to share knowledge are the natural consequences of an enlightened mind." It is a surya sengkala that is chandra sengkala - a Javanese traditional way to symbolise a commemorable year in the lunar calendar, adapted to the solar calendar system. It uses words that express the perceived meaning of the commemorated year while marking the year at the same time, with each word having a numerical value. Thus, the inscription, in reverse order, represents the year CSIS was established: 1971.

SIT 01381/SK/Dirjen PG/SIT/72

ISSN 0304-2170

The Indonesian Quarterly

Third Quarter Vol. 39 No. 3, 2011

Structural Reform In Indonesia

The Asian Financial Crisis of 1997/1998 had led to the '*reformasi*' era. Through IMF's austere policy conditionality under the LOIs, the wide-ranging structural reform was pushed through. But, the IMF-led reform lacked a sense of national ownership and it was prone to criticisms and political condemnation. The one-size-fits-all formula was perceived as a mistake and had left a stigma. In 2003, under the Megawati's administration, structural reform was internalized into *Inpres* that were subsequently issued in 2004, 2005, and early 2006. The most recent reform agenda is the Masterplan on Acceleration and Expansion of Indonesia Economic Development 2011-2025 (MP3EI). The more current reforms offer stronger ownership and a clear legal base, but many times it lacks commitment and disciplines. What we want is a hybrid model based on both national-led initiatives and international best practices. How? First, translate and internalize international commitments into national policies. This is the biggest challenge. Indonesia is very active in ASEAN, APEC, G20, and OECD. In regards to ASEAN and APEC, it could no longer be just an issue of liberalization of the trade and investment, and little bit of economic cooperation or technical assistance because many of the economic integration challenges lie behind the border, not across the border. Second, engage and expose stakeholders, and bring network and international experiences into our own setups. For instance, by having the Corruption Eradication Commission (KPK) representing Indonesia at the G20 Anti-corruption Working Group, anti-corruption efforts can be aligned to international best practices. The OECD has peer reviews on investment and sector-specific policies. Third, involve those who implement the reforms and not only those who negotiate the reform commitments, and enhance domestic support. The Global Financial Crisis of 2008 provides great opportunities for Emerging Market Economies (EMEs) to influence reforms towards a more balanced, strong and sustainable global economy, whose strategies also fit developing nations' interests. [Ed.]

Keywords: Structural reform, Asian Financial Crisis 1997, Global Financial Crisis 2008, ASEAN, APEC, G20, OECD

Since the Toronto and Seoul G20 Summits in 2010, the G20 initiatives for structural reform, targeted to address long-term issues such as unemployment and poverty, have taken on greater significance. Structural reform is needed for several reasons. One important consideration is that the crisis has reduced potential output in many G20 and OECD countries: by 4% in Italy to around 2% in Japan. Structural reform also helps improve fiscal sustainability. Structural reform will also create more balanced growth. Structural reform is a part of the FSSBG (Framework for Strong, Sustainable, and Balanced Growth (FSSB) of the G20. Indonesia is part of the group of emerging surplus economies group and is expected to join the emerging deficit economies group. The emerging surplus group is to help rebalance demand towards domestic sources, while the policy action for the emerging deficit economies is to focus on supply-side measures targeted to strengthen growth and employment. Indonesia's commitments on structural reform include improving fiscal management, improving financial sector policies, and accelerating development. Infrastructure is at the center of accelerating development. Efforts to remove impediments to infrastructure development include regulatory reform, such as the issuance of the presidential regulation to provide a guarantee fund for infrastructure development. The government is providing a bigger budget allocation for infrastructure. In the last five years, the budget for infrastructure has doubled. Institutional support, policy support, and the social safety net program are other parts of the reform. [Ed.]

Keywords: *G20, Structural Reform, Global Financial Crisis, FSSBG, MAP, Infrastructure Development, Emerging Surplus/Deficit Economies, Growth*

The focus of APEC has naturaly shifted to the structural and regulatory obstacles that inhibit cross-border trade. APEC leaders highlighted the importance of structural reform in their 2004 Leaders' Agenda to Implement Structural Reform (LAISR), which indicated that structural reform should be promoted in the areas of (1) regulatory reform, (2) competition policy, (3) corporate governance, (4) public sector management and (5) strengthening economic and legal infrastructure. In August 2008, APEC held the first-ever Ministerial Meeting on Structural Reform in Melbourne. At the APEC Leaders Meeting in Yokohama in December 2010, Leaders agreed that structural reform efforts should be continued and expanded in order to support the implementation of the five elements in the APEC Leaders on Growth Strategy, which is balanced, inclusive, sustainable, innovative and secure growth in the APEC region. In this regard, Leaders endorsed the APEC Growth Strategy Action Plan, which included the APEC New Strategy on Structural Reform (ANSSR). Under ANSSR, every APEC economy including Indonesia has to submit a plan/pledge on its structural reform up to 2015 through Senior Official Meeting (SOM). We come into the conclusion that bureaucratic and administrative reform and regulatory reform are the ones that we can pledge. Why? Because

we have the political support for these reforms. But, there are remaining challenges. [Ed.]

Keywords: *APEC, LAISR, ANSSR, Structural Reform, Bureaucratic Reform, Regulatory Reform*

Restructuring of Institutions as Part of Bureaucracy Reform in Indonesia

Staffan Synnerstrom and Erwin Ariadharma 275-282

Bureaucracy Reform restructuring in Indonesian institutions faces specific regulatory and operational constraints. Law 43/1999 on civil service ordinance, which aimed for a modernization of the Indonesian civil service, failed to fully achieve this goal. One of the root causes of the problem is that secondary or implementing regulations to support the law have never been really developed to replace the old secondary regulations issued under Law 8/1974. Within these regulations, civil service organizational structures and staff establishments are based on symmetric rather than operational considerations with a focus on balanced numbers of units and sub-units and a certain number of positions at each level rather than on what are needed operationally. Another result of the current regulations is overstaffing in most institutions implying a both quantitative and a qualitative redundancy. To be able to design and implement effective reforms, ministries and agencies require some flexibility in determining the appropriate organizational structures and staffing levels based on function, operational tasks, size and workloads rather than on considerations of balance and symmetry. Despite all those shortcomings mentioned above, the momentum towards Bureaucracy Reform, has been steadily gaining strength over the past five years. The initiative began in late 2006 with reforms in the Ministry of Finance, with the Supreme Audit Board (BPK) and the Supreme Court following in 2007, and consisted of significant increases in civil servants pay, improved standard operating procedures and modernized human resources management practices. These agency-specific initiatives have now evolved into a national strategy and action plan for civil service reform with the approval, in December 2010, of the Grand Design of Bureaucracy Reform for 2010 – 2025 and the Road Map of Bureaucracy Reform for 2010 – 2014.

Key words: *bureaucracy reform, civil service law and regulations, restructuring, organizational structure, staff establishment, pay and grading, fiscal constraints.*

Avoiding Middle-income Trap

Infrastructure and Financing in the Context of Avoiding Middle-Income Trap

Rajat M. Nag 283-288

Given the region's enormous growth in recent decades, the idea of the Asian century is certainly feasible. But it is not preordained. Many Asian countries are still very poor, and many others are in danger of being caught in the so-

called middle-income trap. The main factor determining failure or success will be the ability of countries to innovate and upgrade their production processes. This crucial shift also requires flexibility in setting policy, and large investments in human capital and research and development. Relevant basic education must be available to all. In higher education, more investment in science and technology education is needed with a view to creating a skilled and innovative work force. Provision of adequate physical infrastructure is a necessary condition that each and every Asian middle income economy must meet to achieve high income status. Physical infrastructure will play a critical role in meeting the challenges of massive urbanization and is also a key element in achieving higher levels of regional economic cooperation and integration. On the financing side, we are fortunate that Asian savings rates are exceptionally high. The key challenge is how we better use these savings for infrastructure developments. The ASEAN+3 Asian Bond Markets Initiative has been working to deepen domestic capital markets and promote local currency bond issues. This will also help address currency mismatches, a problem which hampers stable, long term financing. Infrastructure funds can help channel Asian savings to finance infrastructure projects in the region. In this regard, mention should also be made of the proposed ASEAN Infrastructure Fund which ADB is supporting ASEAN to establish this year and which will significantly contribute to meeting the financing requirements of the ASEAN Master Plan for Connectivity. [Ed.]

Keywords: Asian Century, Middle-income trap, ASEAN+3 Asian Bond Markets Initiative, Infrastructure, Financing, ASEAN Infrastructure Fund

Globalization

Harnessing Global Diversity

Pascal Lamy 289-300

Globalization dominates our era, but it is an increasingly fragile dominance. Globalization has both enabled — and rewarded — a shift in production, investment and technology to emerging economies. Rising powers, like China, India, Indonesia and Brazil, play a role that was unimaginable even twenty years ago — while smaller developing countries want a say in a system in which they have a growing stake. Yet for all our successes, globalization remains a discontented dream. The recent financial crisis—and the "Great Recession" which followed—was merely the most cataclysmic in a series of global financial shocks. My own view is that deglobalization will not and should not happen. The essential problem today is too little governance of globalization. One challenge is to re-invent international institutions and "networking" institutions in a better way — ensuring that the WTO, the IMF, the World Bank, and the vast UN system operate as a more coherent whole, not a medieval patchwork of fiefdoms. Policy coherence – ultimately – begins at home. An even bigger challenge is to strengthen the global system's legitimacy. Legitimacy also depends on democratising global governance—giving citizen's greater ownership of the system and greater say in its direction. This brings me to the importance of political leadership. The future lies with more globalization, not less -more co-operation, more interaction between peoples and cultures, an even greater sharing of responsibilities and interests. [Ed.]

Keywords: Globalization, Deglobalization, Trade, Global Governance, WTO

Managing Elections

Recent national and local elections in Indonesia have exposed serious shortcomings in electoral governance. Millions of eligible voters continue to be omitted from voters' lists and irregularities persist in critical stages of the election such as candidate verification and vote counting. Such problems have undermined public confidence in the results, leading to frequent disputes and increasing levels of election-related violence. While domestic critics charge that the incompetence of election officials is the main reason for electoral shortcomings, this article argues that a more serious problem can be found in the way powers and responsibilities are divided among election management bodies. The study's findings suggest that further institutional reforms will be needed in order to preserve public confidence in Indonesia's democratic institutions and efforts to consolidate democracy over the next decade.

Keywords: Election, Democracy, Governance

Review of Developments

Structural Reform In Indonesia: Foreword

By Maria Monica Wihardja

On August 2, 2011, the Centre for Strategic and International Studies held a roundtable on "Indonesia's Structural Reform: International, Regional and National Commitments and Progresses." The following four articles are speeches and policy paper prepared by the speakers: Mahendra Siregar, Andin Hadiyanto, Huda Bahweres, Erwin Ariadharma and Staffan Synnerstrom.

Structural reform (SR) is difficult to implement because it needs political will to implement. But, it is worth the effort. A study by the APEC Policy Support Unit (2011) shows that SR is far more important in creating a return to reform efforts than border trade reforms. Another study by the OECD shows that fiscal consolidation when combined with SR will increase economic growth, reduce gross government debt share of GDP, and reduce global imbalances by more than fiscal consolidation alone. SR is also needed because the Global Financial Crisis 2008 (GFC) has reduced potential outputs in many countries around the world.

In Chinese, the word 'crisis' consists of two characters: *wei* means 'danger' and *ji* means 'opportunity' or 'critical point'. For Indonesia, GFC is a 'good crisis' because it may learn some lessons from the crisis without having to go through an austere policy conditionality like Greece or Portugal. However, "there is a risk not to undertake reforms as serious as if we were the ones in crisis, because those who are in great crisis also have great opportunities to reform," said Mahendra Siregar. Indonesia itself can testify to the statement from its experience in 1997. The Asian Financial Crisis 1997 (AFC) had brought a great

albeit painful reform. Under the IMF Letters of Intent (LoI), the 'stick-and-carrot' mechanism worked, although such a reform lacked domestic ownership. Starting in 2004, when the first of a series of *Inpres* was passed to further regulate domestic reforms, from debt management to investment climate, Indonesia's approach to SR has been a 'hybrid approach' between international benchmarks and domestic initiatives. However, unlike in 1997, there is a lack of discipline because there is 'no stick' to push reforms.

What are Indonesia's national and international commitments on SR? Many have criticized the RPJMN II, 2010-2014, for a lack of a clear sense of priorities (Baird and Wihardja in "Survey of Recent Developments," Bulletin of Indonesian Economic Studies, August 2010, stated that it is "easily dismissed as excessive rhetoric, with little impact on budget or policy decisions.").

The Master Plan on Acceleration and Expansion of Indonesia Economic Development (MP3EI), regulated under *Perpres* 32, 2011, comprises of major investment projects on infrastructures, connectivity, and other economic sectors and sub-sectors, with a total worth of 4000 trillion Rp. (US$450 billion) until 2014. There are 9 national laws, 6 government regulations, 5 Presidential Regulations/ Presidential Decrees/ Presidential Instructions, 9 Ministerial Regulations and a number of local regulations and permits including the provincial spatial planning to be reviewed, revised, removed, or issued to ensure the success of MP3EI. However, there are many critiques to the MP3EI, including its unrealistic target dates for its pledged regulatory reform and the absence of "green development" strategies.

Since the Toronto Summit in 2010, the initiatives for structural reform in the G20 have been taken more seriously to address long-term issues, such as unemployment and poverty, according to Andin Hadiyanto. At the G20, Indonesia's commitments on structural reform in the development arena include, firstly, infrastructure, with the infrastructure budget having doubled over the last five years. Infrastructure development is meant to improve not only physical infrastructure but also food security, energy security, water resource management and domestic connectivity. The second commitment on structural reform in the development arena is on policy support, focusing on capital spending, reducing consumption spending, redesigning subsidies, and im-

proving budget flexibility and execution. The last structural reform commitment is the Social Safety Net Support Program. Outside the development context, structural reform is also planned in the fiscal and financial sectors. Not less important is Indonesia's co-chairmanship in the Anti-corruption Working Group, which is represented by the Corruption Eradication Commission (KPK).

In November 2011, APEC Leaders will sign a pledge on SR under ANSSR (APEC New Strategy for SR). As the focal point of ANSSR, Huda Bahweres inserted that Indonesia's approach to draft the pledge is to secure political supports for reforms under existing laws. Two reforms are identified. The first reform is bureaucratic reform (BR), regulated in the Presidential Regulation No.81, 2010. Despite this regulation, existing old regulations continue to impede its implementation, according to Erwin Ariadharma and Staffan Synnerstrom. For example, the civil service regulatory framework based on the National Law 8, 1974. The second reform is regulatory reform. Indonesia is plodding behind in its regulatory reform, compared to the international benchmark. Regulatory issuance is often fee and fiction - based. There are a lot of vertical and horizontal inconsistencies. Moreover, only 7 out of 70 proposed bills were issued in 2010.

What are the strategies to turn words into good deeds? First, we need to know our true national priorities. The RPJMN II does not help much because of its lack of a clear sense of priorities ("everything" is not a priority). Second, there must be a national or multilateral peer review to everything that we have pledged on the international tables. Third, generate results to help going, track good (and bad) records, and get the ball rolling. SR is a long-term (if not a never-ending) process. Fourth, involve stakeholders and gain domestic supports. Include not only negotiators but also implementers on negotiating tables. Reaching a critical mass to push reforms is also necessary. International assistance must be combined with domestic ownership. Use transparent domestic forums to allow vested interests' views to be challenged by pro-reform champions to help reformers win domestic political battles. Indeed, having pro-reform champions in the government also helps. Fifth, gain regional supports such as capacity building and forums to share experiences, or even establish a policy support unit for independent national or multilateral policy reviews.

Indonesia's Structural Reform

Mahendra Siregar

Let's use the most recent history of Indonesia. Otherwise we need to go as far as the transition to *Orde Baru* (the New Order), and it is too far. Let's start with the '*reformasi*' period. The monetary crisis at that time—Asian Financial Crisis—led to Soeharto's downfall and we hit some political crisis. But, as always, crisis creates opportunities for reform. People should not waste a good crisis. Because only "good crisis" can bring up good reform. And we have the testimonial of that. But at the present situation [the Global Financial Crisis of 2008] for us is even better. It's somebody else's crisis and there we still can get opportunities for reform, so it's even better. Anyway, the crisis of 1997/1998—that led to the '*reformasi*'—probably the reason of economic policy management at that time brought in the cooperation of the IMF to improve the accessibility for capital, for the balance of payment, as well as indirectly bring some type of endorsement of the fiscal policy of Indonesia, which otherwise was not credible to the international community. But aside from the financial and the credit facilities provided by IMF, it was also the possibilities for various economic reforms, which were pushed through, as we know very well the terminology of, the Letter of Intent (LoI).

Mahendra Siregar is the Vice Minister of Trade, Republic of Indonesia. This is an edited version of Siregar's keynote address, delivered at a CSIS roundtable on "Structural Reforms: Indonesia's International, Regional and National Commitments and Progresses," held on August 2, 2011, in Jakarta.

The positive side was the wide-ranging structural reform from the sustainable fiscal policy to the monetary key areas and also specific sectors' reform. We understand of what happened with regards to some mega projects at the time being just stopped or put on hold. And then, because of the 'stick and carrot' approach—the stick is of course the LoI, the carrot is the disbursement of the international credit facility or loan at the time—which then provides better commitments and discipline. Because, at the time Indonesia basically was in default, or technically selectively in default, like what happened with Greece today. But at that time we didn't have the EU like Greece, so we could not go to the market with a selective default or default status. So, we needed IMF as the only source, and because of that the "stick and carrot" approach could work effectively. Another good thing about that is the structural reform recommended by the IMF was based on international best practices.

However, the negative side is the perception or probably misperception that this kind of LoI was just another type of new-colonialism, or "neolib". I suppose, that, in a way, the idea was to play the LoI against the national interest. If you combine that with crisis situation and austerity measures, then you have those very big challenges of national resistance. But it's not the monopoly of Indonesia, it happens in EU now, in US now. You just listen to the rhetoric of the Congressmen of US, or the EU Commission or Parliament in Brussels. So, it sounds familiar for Indonesians who were there in 1998-2000.

The other negative side of the IMF's LOIs is the lack of ownership, and it is prone to criticisms and political condemnation. There is no one-size-fits-all formula of reform, and this is I think the biggest challenge from a more objective perspective. The IMF made one-size-fits-all formula prescriptions at that time, and in addition to that, there are too many LoIs at the same time. There should be an explanation about that, but the problem is that in a way it reduced significantly the effectiveness of that type of arrangement of structural reform. As a result, even after now there is a so-called "stigma" against the IMF. When people talk about stigma against the IMF, it is not only the Indonesians or Malaysians who talk about it, but also the Greek people, Eastern European people, and probably other people from South America. And that stigma also applied to a lesser extent to a few other international

organizations. So, you could see there is a sentiment against the World Bank, against many other organizations for a lesser extent.

Because of that, in 2003, during the Megawati's administration, in which Bapak Dorodjatun was the Coordinating Economic Minister, Pak Boediono the Finance Minister, and Pak Burhanuddin Abdullah the Governor of Central Bank, we discussed the transition to internalize structural reform. So, what happened was that at that time we issued an *Inpres* (Presidential Instruction) of five where we included four elements of the structural reform: one is the continuity of fiscal sustainability, monetary and banking reform, and then we add up even bigger and more ambitious agenda of improving investment climate and then later of course infrastructure development. The most recent agenda to date is the Masterplan on Acceleration and Expansion of Indonesia Economic Development 2011-2025 (MP3EI). There were three *Inpres* issued in 2004, 2005, and early 2006. The positive sides of this are stronger ownership and a clear legal base. At that time there was *Inpes* and of course now with MP3EI is the *Perpres* (Presidential Regulation).

We also involve more institutions. During the LoIs, there were only the three institutions, the *Menko* (the Coordinating Economic Ministry), *Bappenas* (National Development Planning Agency), and BI (Bank Indonesia). But indirectly there were other organizations and institutions as well but these were the most direct institutions involved. Since 2004 it involves more institutions, including for instance, from the investment climate involvement of Ministry of Home Affairs in connection with the issuance of many local regulations that made investment climate worse off. We should coordinate the consistency of local governments' regulations with national legislations, and then as a result thousands of local government regulations were cancelled. So that would be the positive side of it.

The not very positive side is, unfortunately, the lack of commitment and discipline because there is no "stick and carrot". Earlier, it was very raw and later on we modified that and linked that to some type of perimeter where ministers and officials are judged based on their performance, on their achievements of this action plan or very clear targeted outputs. And another not very positive side is many of them were not necessarily the best international practices and benchmark. So I think this is the risk of having developing our own reform

agenda, namely the possibility of not looking at the international best practice.

Now how I look at the situation and opportunities is some type of hybrid. Hybrid is very much strong in national ownership and leadership, but with international benchmark. Hopefully with that combination then we can have the best of two sides.

How? We are very active on the international commitments of Indonesian structural reforms, as well as the national commitments. We are very active in ASEAN, APEC, G20, OECD. Among others, the ASEAN was a part of the many nationalized structural reform timetables. I still remember, because part of the 2007 program, there were two of those: the overall ASEAN Community Blueprint deliverables and the part of the agreement of the services that is the AFAS (ASEAN Framework Agreement for Services). AFAS was then internalized into the issuance of the Negative Investment List (*Daftar Negatif Investasi* or *DNI*). So within the DNI, there is now a special note that would allow different treatments for companies based or owned by ASEAN members.

So, there is another way to approach this. Our international commitment is internalized and then reflected in the national regulations. So that was what happened. In regards to ASEAN, I just attended the so-called the ASEAN high level task force (HLTF) on regulatory reform that was held in Jakarta. We started having a roundtable like this to hold dialogues on regulatory reform. And of course regulatory reform is very much the key in the structural reform, in addition to institutional reform, and probably sectoral approaches.

In ASEAN itself, we have many other key important activities and action plan like the Chiang Mai Initiative Multilateralization (CMIM), the ASEAN+3 Macroeconomic and Research Office (AMRO) in Singapore, and then the most recent decision by the Finance Ministers and Deputies to launch the ASEAN Integration Monitoring Office (AIMO) within the ASEAN site. So there are many setups that could improve the possibility of monitoring the effectiveness of structural reform at the country level, including Indonesia. So, I think this is the way we could do it. I don't include IMF as an international organization for best practices because the stigma is still there. While, for the CMIM for instance, it is actually a proxy to many of the IMF facility, or the credit

loan facility (FCL or Flexible Credit Line) of the IMF—which of course because of the stigma, we could not access it. We hope the CMIM could become the effective substitute and then at the same time still make use of many of the international best practices. So that is a creative intention, the way I look at it, and I entitle it the hybrid approach. So the hybrid could be national, could be also regional, but it applies for the other organizations as well. APEC is the same. It's the individual action plan, peer review, the LAISR (Leaders' Agenda to Implement Structural Reform) and then the ANSSR.

Basically, with regard to the ASEAN and APEC, people understand that now it could no longer be just an issue of liberalization of the trade and investment, and little bit of economic cooperation or technical assistance, but of course hopefully it is pushed by the credit and investment facilitation. Because many of the economic integration challenges lie behind the border, as we call it, not just across the border. So despite the liberalization you cannot go further because of the issues and challenges happening at behind the border. So I think this is where we need correctively to look into the issues. That also applies for the G20. We have so many agenda that could easily be considered as a very heavy requirement for structural reform: fuel subsidy, commitment on regulatory reform, on the financial and banking, and then of course, the mother of all reform would be then facilitated in the FSSBG, which is the framework for strong, sustainable and balanced growth.

Basically we look at the crisis that happened in the 2008/9 globally from a perspective that would require a global reform. So this is like I said, the mother of all reform. You require a global reform to address global crisis. And in the next question is of course very logic, "Where to start?" We'll need at least another five roundtables to discuss that. But the point is now it is not only individual country that requires structural reform, it requires coordinated all countries' participation as much as reform of the global governance. .

And of course, the regulatory reform for anticorruption activities are very relevant for Indonesia because these are very much vital for the institution. That's why we create a hybrid engagement in our representation at the G20. Indonesia basically is represented by KPK at the G20 on anticorruption. Because in other countries they are all represented by the Treasury, mostly. Of course the treasuries in many

countries are very knowledgeable in this issue, but our emphasize is not only about the contribution of the knowledge, but how to then implement and have our own reform that will comply with international best practice. So that's why we are the only one who brings in the independent institution like KPK in the G20 for anticorruption. As the result, for instance, we hosted the last international anti-bribery meeting in Bali, which was also followed by G20 working group meeting. So our KPK and other institutions nationally have become much stronger and more confident in taking up international best practice setups or policies with regard to anticorruption. You could imagine if they are not exposed and engaged then they could come up with ideas of structural reform, and then at the end of the day we don't know what kind of reform are we going to have. For developing countries, it is as important as our contribution in the international organizations deliberation. The direct engagement and international exposure, will enhance the network and experience that would benefit our own setups.

Also at the OECD, we started a couple years back with the policy framework for investment. So it was also done collectively by almost ten institutions. And we had the peer review at the OECD headquarter in Paris with the Committee on Investment, and then on sector specifics, like this year we are going to also invite OECD to look at our agriculture policy. The positive side is its compliance with international best practices, mostly, and then this is the place where you can exchange experiences, while still maintain strong ownership.

Also, it involves more institutions now, not only Ministry of Trade in ASEAN, or not only the Coordinating Economic Ministry, or the Foreign Affairs Ministry for APEC. It has to be more and more institutions because the benefit is also for the involvement itself. The challenges, the same like other international issues, is how to translate and internalize that into domestic regulations. And how to strengthen the institutions' commitment and discipline. For instance in my ministry, the Ministry of Trade, those who go to many negotiations or discussions—our negotiators—of course they are well equipped with the advisors from many relevant technical ministries. But once they come back, it is the same technical ministries that have to issue the domestic regulations, and then when they were asked about the commitment, "No, it

was you that negotiated the agreement, you were there, I didn't sign it myself."

So that kind of gap between what is committed and what is implemented is farther than if they are the part of the same ministries, but that's why we have to get more involvement. And then engage domestic support from multi-stakeholders. I think this is very key. In my own experience, since I become the Sherpa to G20, I have been invited by many civil society organizations on many issues, which the main interests is in the development issues and anticorruption. Understandably, they are critical pessimist, 'why would Indonesia bother to become the co-chair of the anti-corruption working group? Shouldn't we just focus on our own domestic challenge instead of trying to preach others about anti-corruption with not very good domestic track record?' And I said, with or without international involvement, the domestic issues are always the biggest challenge, and of course the main attention should focus on our own corners. But by having this international connectivity, then we can bring domestic issues closer to some international best practice and compliance. So I think this is something we need to push further.

The Global Financial Crisis of 2008 provides great opportunities for Emerging Market Economies (EMEs) to influence reforms towards more balanced, sustainable, that fit with developing nation's interests. I think it is very clear, because otherwise their mindset of the LoI and one-size-fits-all approach would lead to the same mistake, and undermine this credible or strong-sustainable-and-balanced-growth-based reform. With our "relatively" better economic performance we have more chances to influence the direction of this discussion. So whatever agreements and consensus, it could be better reflecting the balance and more understanding with regard to developing nations' concern and interest.

So this is a once-in-a-lifetime possibility for us. As I indicated earlier, this time it is not our crisis but still provides the big opportunities for reform. It is somebody else's crisis, so we don't have to experience the tough austerity measures like in the many other countries. However, there is a risk not to undertake the reform as serious as if we were the ones in the crisis. Because like I said, those who are in great crisis also have great opportunities to reform.

Structural Reforms in the G20

Andin Hadiyanto

Definition

The many definitions of structural reforms (SR) have a common theme. SR is to provide an enabling environment to support sustainable economic development. We call it sustainable economic development because SR focuses on the environment for the medium-term or long-term. Gleason (2004) defines SR as being: "to create a favorable policy environment for accountable, transparent government with a well-defined public and private sector working in mutual reinforcing ways to promote prosperity and sustainable development. SR consists of a package of inter-related policy correctives designed to improve both external and internal policy environments." Many types of reform policies are designed to improve both external and internal policy environments. An external policy is designed to enhance a country's ability to benefit from globalization (trade and international capital issues). This is done so that price signals better reflect true economic costs and those price signals attract factors of productions to their highest value uses. An internal policy is designed to improve the efficiency of government functioning, regulatory, and oversight capacities with respect to the

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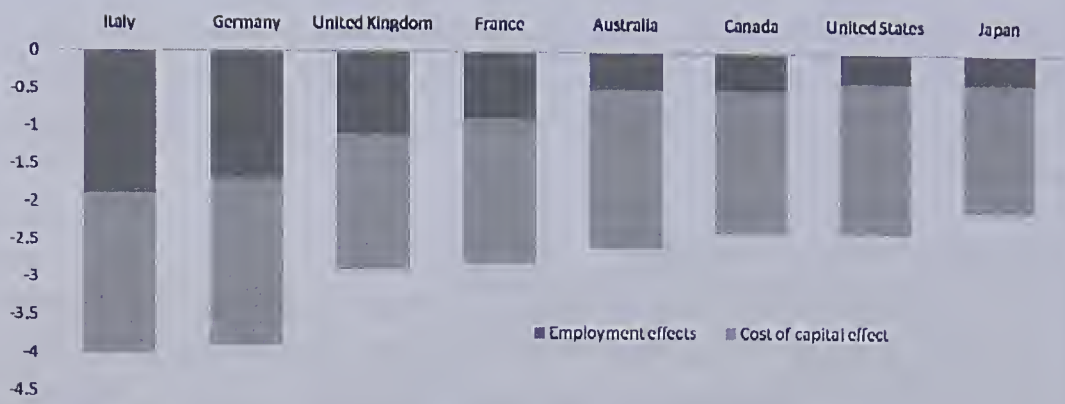
maintenance of a policy environment for private economic activity. So, SR covers many areas including governance, state capacity, transparency, competition policy, and the balance between public and private economic activities.

Structural Reform in the G20

Why has the G20 taken an interest in SR? Initially, the discussion in the G20 focused on macroeconomic stability and the financial sector. The Leaders' Summit in Washington discussed how to address the immediate crisis threatening the global economy – how to address macroeconomic stabilization and the financial crisis. Along with the improvement of the world economy, other priorities emerged that challenged the G20 leaders. In particular, the issue of unemployment and poverty became a key question for the G20. It is a simple question with very important implications but one that is difficult to answer. When Leaders met in Toronto in 2010, they discussed further the issue of unemployment and poverty. It was agreed that there should be equal focus on the long-term issues of economic cooperation as well as the macroeconomic policy issues. One of the vehicles for long-term cooperation is SR. SR address the crisis not only as a short-term issue, but also as a long-term issue. So, since the Toronto Summit, and followed up by the Seoul Summit, the initiatives for SR in the G20 have been given greater attention.

SR is needed because the crisis has reduced potential output in many G20 and OECD countries. By some estimates, the reduction is 4% in Italy to around 2% in Japan (Figure 1). This reduction is a result of two effects: employment and cost of capital. Employment problems also have political consequences. So, there are two possible reforms considered: a more efficient cost of capital and also employment generation. The other reason why the G20 leaders discussed SR in the G20 is because SR can boost economic growth. Economic growth (recovery) will be much higher when SR is combined with sustainable fiscal policy (Figure 2). The idea is that the SR will improve productivity, and productivity, of course, will strengthen economic growth.

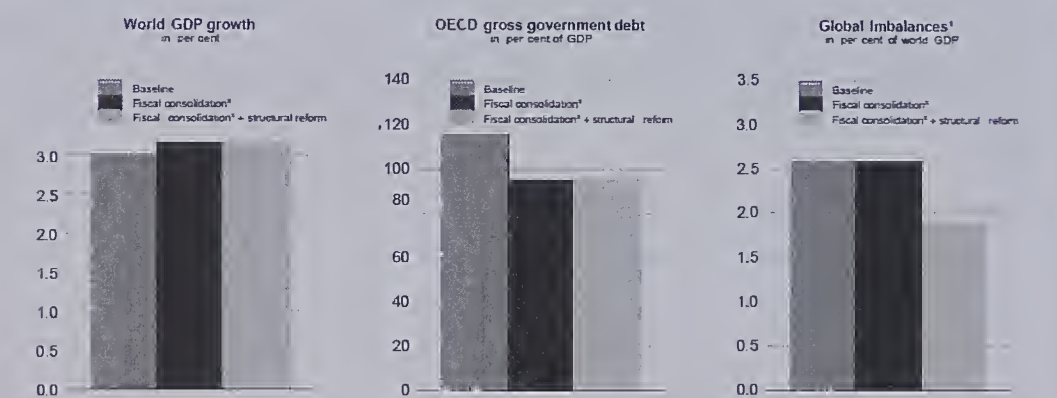


Source: OECD

Figure 1: Reduction in Potential Output, in %

Structural reform can do much to sustain growth and reduce global imbalances

Policy simulations, 2016-25 average



1. A summary measure of global current account imbalances is constructed as the absolute sum of current balances in each of the main trading countries or regions.
2. Fiscal consolidation including exchange rate response.

Source OECD calculations.

Figure 2: Policy Simulations, 2016-25 Average

SR will also improve sustainability in terms of policies. Figure 2 shows that the debt/GDP ratio declined significantly if OECD countries adopted SR. Again, SR will improve the fiscal position and a better fiscal position will improve the debt/GDP ratio.

The third is that improved fiscal policy in the OECD countries will also help address global imbalances. This is because SR will improve saving and investment and current account imbalances thereby creating a more balanced global growth. So, we can see that SR will support sustainable growth, strong growth, and balanced growth.

Mutual Assessment Process and the Framework for Strong, Sustainable and Balanced Growth

During the G20 Leader's Meeting in Seoul, a more complete action-plan initiative was formulated. This plan is called the Mutual Assessment Process (MAP) to achieve strong, sustainable and balanced growth (Figure 3). SR is a part of the FSSBG (Framework for Strong, Sustainable, and Balanced Growth) in the G20. SR is also part of the APEC forum. Structural reform will support strong growth, balanced growth, as well as sustainable growth.

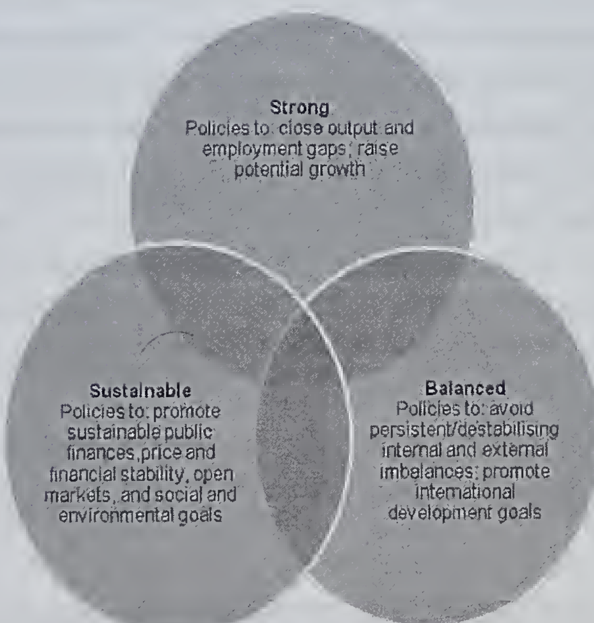


Figure 3: MAP for Strong, Sustainable and Balanced Growth

The commitments under the G20 FSSBG are not binding. But, the delivery of the SR commitments is very important because it will enhance both the credibility of the country adopting the reforms as well as the G20.

Objectives of FSSBG

The commitments in the G20 have several objectives. They represent the common understanding of the risks/vulnerabilities among countries and the framework for coordinated actions to address these risks. The commitments move beyond generalities to concrete actions. We were asked for more concrete commitments in Canada and Korea.

Most of Indonesia's G20 commitments reflect what is already being pursued domestically. Each member reports on the progresses of their commitments. Finally, members are committed to the medium-term understanding to use the framework process for ongoing discussion/ action.

Risk and Vulnerabilities

There are many understandings regarding risks and vulnerabilities. The main risk or vulnerability is the persistent unbalanced global growth with ongoing large current account imbalances. Currently, we know there is sluggish growth and high unemployment rate in many advanced economies, while there is strong growth and the risk of overheating in emerging market economies. Meanwhile, some countries need further exchange rate adjustments. Other challenges include high or volatile capital flows, high or rising commodity prices, financial sector weaknesses, and unsustainable sovereign debt. These issues are the main concerns to be addressed by macroeconomic policy and SR in the G20 economies. The evolution of these risks reflects partly the need for progress in fulfilling past policy commitments.

SR is a part of the MAP. Here, the macroeconomic policy starts from exchange rate flexibility, sound financial sector, and also sustain-

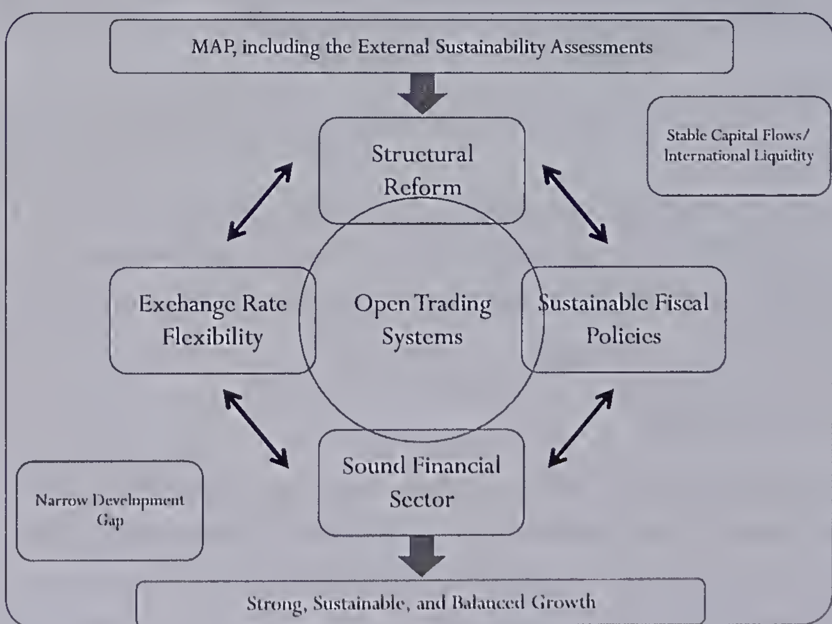


Figure 4: SR in MAP

able fiscal policies (Figure 4). Those macroeconomic policies hand-in-hand with SR are targeted to create the strong, sustainable, and balanced growth in the future. Besides that, the G20 has developed initiatives targeted to narrow the development gap. A narrower development gap will support strong, sustainable and balanced growth.

Four Groups in the G20

Following extensive technical discussions, Leaders agreed to group G20 members into four broad groups for the purposes of the discussion on macroeconomic issues (Table 1). The groups are: the surplus advanced economies, deficit advanced economies, surplus emerging economies, and deficit emerging economies. The groups are defined according to their status as advanced or emerging and the external current account balance. Concrete and focused strategies are spelled out for each group with the goal of boosting global growth. Indonesia is part of a group of surplus emerging economies, together with Argentine, China, Saudi Arabia, and Russia. The G20 is looking to this group of economies to rebalance demand towards domestic demand. This policy course is in line with what Indonesia did during the Global Financial Crisis in 2008; a strategy that helped Indonesia sustain one of the highest growth rates in the G20.

Table 1: Four Groups in the G20

<table>
<tr><th></th><th>Surplus</th><th>Deficit</th></tr>
<tr><td rowspan="2">Advanced economies</td><td>Product and labor market reforms
(Germany, Japan, Korea)</td><td>Credible fiscal consolidation over the medium term
(Australia, Canada, France, Italy, UK, US)</td></tr>
<tr><td colspan="2">Accelerate financial repair and reform</td></tr>
<tr><td>Emerging economies</td><td>Rebalancing of demand towards domestic sources
(Argentina, China, Indonesia, Saudi Arabia, Russia)</td><td>Supply measures to strengthen growth and employment
(Brazil, Mexico, South Africa, Turkey)</td></tr>
</table>

Indonesia is in a period of transition in the sense that it is moving from a current account surplus toward a small deficit. This reflects the expectation that as investment grows, Indonesia will need to import capital equipment to increase potential growth even further. Consequently, Indonesia may well move from the emerging surplus economy group to the group of emerging deficit economies. The policy action for the emerging deficit economies is to adopt productivity enhancing supply measures to strengthen growth and employment. These measures must overcome supply bottlenecks like infrastructure problems as well as social problems. In practice, Indonesia's policies combine measures set out for the two emerging market economy groups. Indonesia uses a hybrid strategy of the emerging surplus economies and the emerging deficit economies.

Deliverables from G20 Structural Reform Under FSSBG

The Framework for Strong, Sustainable and Balanced Growth (FSSBG) is the over-arching framework covering financial reform, macroeconomic challenges, and fiscal area (Figure 5). When Indonesia refers to SR in Indonesia or in developing countries we also have in mind SR in the context of development. Many G20 countries have different initiatives on SR, from infrastructure initiatives to social safety

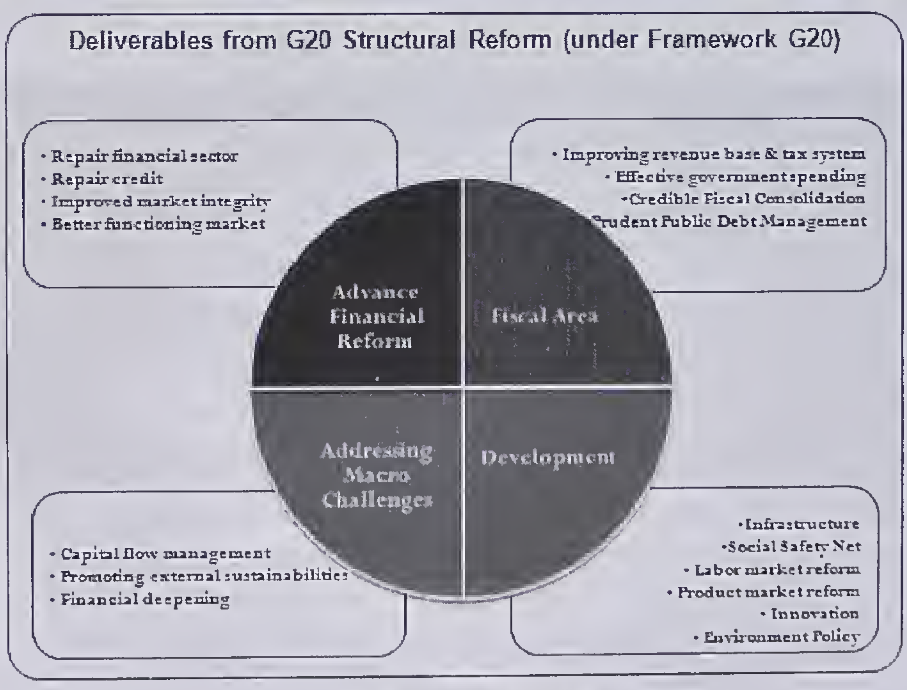


Figure 5: SR Initiatives

net, labor market reform, product market reform, innovation and environment policy. For example, Korea has environmental policy and many advanced economies focus on labor market and product market reforms. For others, like Indonesia, infrastructure and social safety net reform are the areas of focus.

Indonesia's Structural Reform

Table 2 shows Indonesia's SR commitments in the G20. The third part of the table concerns accelerating infrastructure development, which is the main reform focus. Accelerating infrastructure development is targeted to address supply bottlenecks. Efforts to remove impediments to infrastructure development include regulatory reform, the government regulation to provide a guarantee fund for the public infrastructure development, and also government provision of greater budget resources for infrastructure. In the last five years, the budget for infrastructure doubled, even though there is still not enough funding given the scale of the need for infrastructure.

Institutional support is an additional part of our infrastructure policy along with regulatory reform and budgetary provision. The agency for investment is more or less like a sovereign wealth fund that focuses on infrastructure development. A second area is policy support, focusing on the capital standing, reducing consumption spending, redesigning subsidies, and improving budget flexibility and execution. To give a bigger credit support for infrastructure development, we need to redesign the national budget, particularly by phasing out energy subsidies that are becoming more and more burdensome to the national budget. This also becomes a commitment to the G20. Finally, besides accelerating infrastructure development, we can support investment and increase demand. Infrastructure includes not only physical infrastructure, it includes infrastructure to strengthen national food security, national energy security, water resource management, domestic connectivity for goods, and to strengthen the domestic/ local economy. So there are many targets underlying the development of infrastructure (Table 2).

Table 2: Indonesia's Commitment on SR

COMMITMENT	STRATEGY
Improving fiscal management	• Improving government revenue without burdening private sector • Improving the design and effectiveness of spending • Focusing government financing on using domestic sources • Improving government debt management • Improving fiscal decentralization and local government fiscal management
Improving financial sector policies	• Integrating macro prudential policies into the framework of monetary policies • Supporting financial deepening through market instrument development • Refine prudential banking • International Banking Architecture & Capital Market Blueprint • Developing Islamic banks • Promoting financial inclusion
Accelerating development	• Accelerating infrastructure development to address supply bottle neck • Regulatory reform (Perpres 13/2010) on government guarantee for infrastructure project. • Fiscal instrument (budget allocation) • Institutional support (establishing PIP) • Policy support (focus on capital spending, reducing consumption spending, redesigning subsidy, improve budget flexibility and execution, etc.) • Supporting the most vulnerable • Cluster I: family based social assistance programs • Cluster II: community empowerment programs • Cluster III: expanding economic opportunity for low-income households

And the third initiative is the social support program. We are supporting the strategy for pro-poor development in Indonesia. We divide it into three clusters. The first is family-based social assistance programs, in which we give assistance to the poor people. The second part is the community empowerment programs, in which we give the fund for the community to manage. This is known as -*PNPM Mandiri*. And, the third is expanding economic opportunity for low-income households. This involves giving credit for people or to the SME to expand their economic activity.

Overview of the APEC Structural Reform

Huda Bahweres

Introduction

In order to be involved or to understand structural reform(SR) issues, we need to engage and force ourselves to know about the issue, especially the importance of the issue. A country that abandons SR might be in the position of being trapped as a lower middle-income country. So, this is a very important. Maybe the threat is very high, but we never realize how important SR is. SR are reforms in institutions, regulations, and government policies, so that behind-the-borders barriers can be minimized to increase the economic capacity. So, barriers that can impede trade and investment, barriers that can decrease our quality of life, and barriers that can harm our business climate are subject to SR. SR can also be applied to financial sector, but the above-mentioned fundamental reforms such as institutional reform are keys to SR.

APEC Leaders' Agenda on SR 2004

APEC has historically focused on removing cross-border impediments to trade liberalization and facilitation. As tariffs, quotas and other trade barriers at the border have diminished in the APEC region,

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the focus of APEC has naturaly shifted to the structural and regulatory obstacles that inhibit cross-border trade by creating "behind-the-border" barriers to improving business performance. APEC leaders highlighted the importance of SR in their 2004 **Leaders' Agenda to Implement SR** (LAISR) which indicates that SR should be promoted in the areas of (1) regulatory reform, (2) competition policy, (3) corporate governance, (4) public sector management and (5) strengthening economic and legal infrastructure. Two of the aforementioned issues are not directly related to economics namely regulatory reform and public sector governance. **The Economic Committee** was subsequently charged with responsibility for leading APEC SR work programme. However, APEC is not a negotiating forum, but non-binding. The main activities of APEC are knowledge sharing, best practices, and capacity building on SR. In 2005, the Economic Committee established **APEC Forward Work Programme on LAISR towards 2010** (LAISR 2010), which ended last year.

LAISR has the highest political commitment since our leaders signed the agreement. But, we often forget about our commitment. Not only at the leaders' level, but also SR program is endorsed at the ministerial level. In August 2008, APEC held the first-ever Ministerial Meeting on SR in Melbourne. Indonesia was represented by the Minister of Finance. In the Joint Statement, Ministers underlines the importance of Regulatory Reform as a fundamental aspect of SRSR. Regulatory reform is indeed a fundamental aspect of SR. We cannot succeed to implement SR without regulatory reform. But, what kind of regulatory reforms should we have? There are best practices. There are guidelines. Regulatory reform does not mean only issuing new regulations. In this regard, APEC Good Practice Guide on Regulatory Reform was endorsed. Among the issues highlighted in this good practice guide are that in making a regulation, we should first define what the problem is, and not only just issuing regulations. In Indonesia, there are a lot of problems in our regulations and regulation making so that there are a lot of overlapping and contradicting regulations. There are eight or seven principles of good regulations. One of them, which we often forget, is regulation review. Regulations need to be reviewed. Regulations do not live forever. Regulations have time, place, and appropriateness. So, do review and not only issue. We often think that regula-

tory reform is all about issuing *Inpres* (Presidential Instructions), *Kepres* (Presidential Decrees), or other new regulations. Maybe, we need to discuss whether this is all we need.

EC is tasked to conduct stocktaking of LAISR 2010 and efforts on domestic SR of APEC Economies. From 2006-2010, every time the EC meet or every time before the EC meet, there are initiatives about the aforementioned five issues. Every economy is asked to contribute voluntarily in each of the issues. One of the issues that Indonesia does not dare to contribute is on regulatory reform. As the focal point of LAISR, I am ashamed of our regulatory reform. We do not have an institutional framework and we do not have any regulatory policy so that when we are asked, we are ashamed. I hope that the National Law 10, 2004, that is going to be reformed can be a way out of this. For all the other issues, we are in a pretty good shape.

APEC Ministerial Meeting on SR (SRMM) 2008 and LAISR Stock-take

LAISR Stock-take 2010 was requested by the SR Ministerial Meeting in 2008. The stocktaking is conducted through a survey of EC members economies. The stock-take report has concluded that the LAISR initiatives has made significant progresses in all of the five LAISR areas, such as regulatory reform to create business-friendly environments and various efforts to improve public sector governance. There are some key findings of the Stock-take Survey. The first on is **leadership and high level involvement.** Since SRs tend to have adverse impacts on sectors which were previously protected, they could be watered down without strong leadership even if they are well planned. Some developed countries have shown their highest-level involvement on SR. Australia for example has a productivity commission, who has the authority to review regulations and withdraw any regulation, under the Prime Minister. Mexico, albeit a developing country, also has a unit with such power. Also, South Korea has conducted the Guillotine approach.

The second one is **institutional framework**, including a effective inter-agency coordination mechanism and appointment of dedicated ministers. This indicates the importance of having cross-cutting viewpoints in carrying out reforms even when discussing sector-specific issues. With respect to Indonesia, there is a suggestion to establish an

independent regulatory review body. That is the best. But, we already have too many institutions. We do not need to add national burden to establish another new institution. Just empower the existing ones. Empower the Minister of Finance, or empower the Coordinating Ministry of Economics, or empower other ministries that have and are given the full responsibilities to work on SR. SR should be multi-faceted and not only on specific sectors. So, there has to be institutions, institutional framework and a clear process.

The third one if **effective communication and consultation with stakeholders.** It is crucial to involve a wide range of stakeholders in the reform process in order to identify priority areas, ensure transparency, and prepare detailed design for reform. There are vested interests, status quo, and costs to reform. These have to be communicated, have to be clarified and receive support from all stakeholders. Supports have to be sincere and on-the-surface. If we are to make national laws, there have to be academic studies, but not those studies that are made-to-order and made to legalize national laws. Maybe, I am wrong about this. What is meant by country-consultation is really a grass-root approach. If we want to make regulations about street food stalls, then we want to ask the street food stallers. We have to do all these if we are to be recognized in implementing good and appropriate SR. Other key factors for the success of the reforms cited in the survey include **effective publicity, change of mindset and culture of public servants**, and **consistency and continuity of policies.**

APEC Best Practices on SR

There are all best practices that we can follow and in fact, should follow as a member of APEC economies. We come and attend APEC meetings every year, and we saw, took notes, endorsed, but maybe we forget to implement them or have not yet implemented them. The APEC-OECD Integrated Checklist on Regulatory Reform has very simple questions that have been designed by OECD in a very simple way. They are very simple questions but difficult to answer. " Do you implement Regulatory Impact Analysis when you prepare the new regulation?" If we are honest we will say, "No". "Do you have institutional framework?" We will say, "No". If all of the answers are "No," we are ashamed to follow the self-checklist assessment. At the end,

only developed countries that volunteer to do it. There are also Good Practice Guide on Regulatory Reform, handbook for "the APEC Voluntary Reviews of Institutional Frameworks and Processes for SR" (PSU), and Good Practice Guide on Public Sector Governance, for best practices on SR. But, only developed countries thrive in these, although in regards to public sector governance, we already made some progresses which we could be proud of.

That is also the reason why now the name LAISR is changed to ANSSR for APEC New Strategy for SR. Developed economies seem to be impatient to wait for us, for the developing economies, to move forward in the SR. In 2010, LAISR that started in 2004 became APEC's SR Agenda Beyond 2010 or LAISR Beyond 2010 or ANSSR. LAISR Beyond 2010 has the same agenda of that of LAISR with an addition of "Ease of Doing Business" (EODB).

APEC Ease of Doing Business

In regards to EODB, Indonesia is ranked quite low in the list. APEC EODB is initiated by Singapore who is always ranked number one, and because Singapore may share its experiences with the rest of the APEC economies, this initiative was endorsed. This also means that our leader, our President, endorsed it. We, as lower-ranked officials, have to remind our leader about this endorsement. APEC EODB is a combination of IFC-WB Doing Business and the APEC SR Initiatives. IFC-WB Doing Business is first published in 2004 and has an annual survey. It starts with 10 indicators. APEC SR Initiatives are aligned with regulatory reform and has an identification on priority areas. APEC EODB Plan 2010-2015 was officially endorsed by APEC Economic Leaders Meeting in November 2009. APEC inspirational target is 5% increment of a faster, easier, and cheaper business environment by 2015. Five priority areas are starting a business, getting credit, enforcing contracts, trading across borders, and dealing with permits. It follows a tailor-made approach with diagnostic report. There are six Champion Economies to help out economies that need helps, including Indonesia. In Indonesia, there are problems in coordinating the five priority areas. Indonesia Investment Coordinating Board (BKPM) sometimes coordinate the five areas but sometimes not. We cannot hope too much to improve EODB this year without a good coordination.

Indonesia's Initiatives and Contribution on LAISR Agenda

Indonesia has initiated and contributed to the LAISR agenda. These include:

1. **Inviting High Rank Government Officals, Expert and Academicians** to participate as Speakers as well as participants in all LAISR Capacity Building Activities.
2. **Getting Assistance on the Research on Public Consultation in the Rulemaking Process in Indonesia in 2010**. The results were presented on the APEC Workshop: Improving Public Consultation in the Rulemaking Process, 29-30 October 2009 in Jakarta.
3. **Seminar/Workshop and Training**
   - APEC Seminar on Utilizing "The APEC-OECD Integrated Checklist on Regulatory Reform" in The Competition Policy and Deregulation Aspects (Jakarta,13-15 June 2007);
   - APEC Seminar for Sharing Experience in APEC Economies on Relations Between Competition Authority and Regulatory Bodies (Bali, 11-13 June 2008).
   - The 4th APEC Training Course on Competition Policy (Bali, 5 – 7 November 2008).
   - Workshop on Enforcing Contracts – 26 January 2011 funded by the Republic of Korea.
4. **Getting Assistance on Diagnostic Research on Doing Business**
   - Diagnostic Study on Starting a Business (14-23 July 2010), The study "Making it Easier to Start a Business in Indonesia" with the recomendation has been distributed to related Ministries/Agencies and presented in BKPM-Roundtable Workshop on Doing Business, Bandung 4-5 November 2010
   - Diagnostic Study on Indonesia's Enforcing Contracts – in Progress

The APEC Economic Policy Report (AEPR)

The main publication of the APEC Economic Committee since 2006, serve as an important source of information for government officials,

academics, and other stakeholders on the key SR issues in the APEC region. **The 2006 AEPR Overview of SR Agenda** provided a high-level overview of the SR mandate given to the EC. It started with a brief summary of the work that APEC undertook on SRSR and its policy implications, examined sustainable development issues with an emphasis on the role of SRSR, and reviewed individual economies' domestic SRSR activities over the past 10 years. **The 2007 AEPR – Public Sector Governance** established a range of generalized high-level principles for good public governance and identified key tensions in public sector governance and the processes that had evolved to overcome these challenges. It also focused on domestic institutions to support reform.

The 2008 AEPR – Competition Policy shared lessons about how APEC economies had adopted and had been enforcing competition policy, highlighted achievements and activities by APEC in competition policy, and helped formulate the focus of future competition policy work. **The 2009 AEPR – Regulatory Reform** outlined key elements of a good regulatory reform framework, measured the regulatory burdens on business, and reviewed individual economy experiences in implementing regulatory. **The 2010 AEPR - Corporate Governance** provided insights into the relationship between corporate governance and sustainable economic growth. It outlines the formal analysis supporting that relationship and highlights salient issues and related key recommendations.

LAISR Stocktaking Report -Taking Stock of the Progress in the LAISR Initiative and Structural Policies in APEC Economies is about Rich information on the progress of SR in APEC has been collected through a survey of EC members, to which all economies responded.

Indonesia has been able to coordinate with different institutions to contribute to these publications, except on regulatory reform. We cannot lie that we are not yet on the same stage of reform as other economies. But, we are pretty confident about the rests of the reforms. So, only in 2006, the year I just joined APEC, and in 2009 that Indonesia did not contribute.

APEC New Strategy for SR (ANSSR)

LAISR 2010 Agenda focused on priorities mostly related to trade and investment facilitation and behind-the-border issues. At the same

time, in the context of the recent global financial and economic crisis, APEC recognized the necessity of formulating a more comprehensive and long-term growth strategy, of which SR is a critical component. At the APEC Leaders Meeting in Yokohama in December 2010, Leaders agreed that SR efforts should be continued and expanded in order to support the implementation of the five elements in the APEC Leaders on Growth Strategy, which is balanced, inclusive, sustainable, innovative and secure growth in the APEC region. In this regard, Leaders endorsed APEC Growth Strategy Action Plan which includes APEC New Strategy on SR (ANSSR). Implementation of ANSSR was formulated based on the recognition that SR work in APEC needed to extend beyond LAISR's five priority work streams to identify additional key areas that APEC economies could pursue and that APEC's agenda for SR should also expand to become a shared APEC-wide objective, with all relevant APEC Groups taking part. The extended priority areas are given in Figure 1.

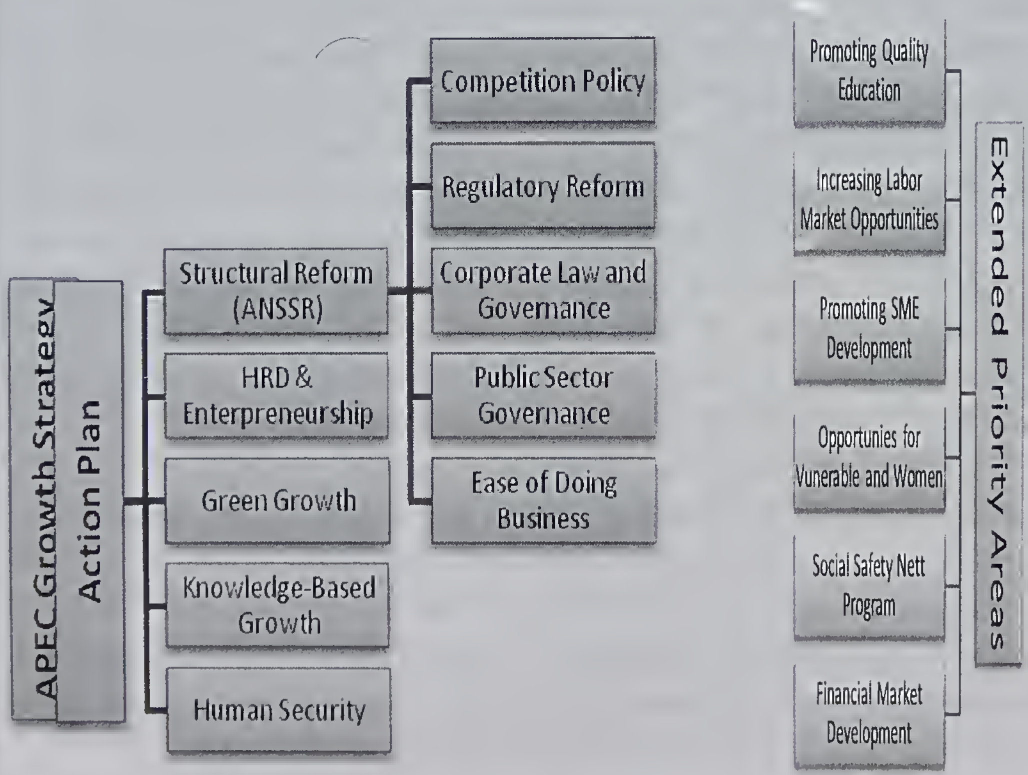

Figure 1: Extended Priority Areas within ANSSR

Indonesian's Pledge under ANSSR

Every APEC economy including Indonesia has to submit a plan/pledge on its SR up to 2015 through SOM. This pledge can be considered as "a binding commitment" and will be closely monitored and measured every year. A priority (ies) of SR must be selected either from the 5 issues of SR or sectoral reforms. The pledge will be submitted by the respective APEC Leader, including the President of the Republic of Indonesia, on November 2011.

We come into the conclusion that bureaucratic and administrative reform (BR) and regulatory reform (RR) are the ones that we can pledge. Why? Because we have the political support for this. BR is mandated by Law No. 25/2009 on Public Service and Presidential Regulation No. 81/2010 on the Grand Design of Bureaucratic Reform 2010-2025. It is the first national priority on the 2nd stage of Mid-Term Development Plan (RPJMN II, 2010-2014). RR is one of the of the pre-requisite for successful MP3EI Development plan, which is mandated under the Presidential Regulation No.32/2011. It is the key factor of Development Plan on both RPJMN II and the MP3EI. It will be implemented by reviewing and/or revising (debottlenecking) regulations that impede the investment. RR is also identified as the centre of BR, which is impeded by many existing old regulations. The challenges ahead include a lack of political support or high-level commitment. There is no institutional framework to conduct the reform. There are resistances from groups/stakeholders that have a vested interest in the status quo. Lastly, the benefits of structural policy reform are not generally well understood by the public and stakeholders.

APEC can contribute to improvements in members' domestic policies by fostering meaningful dialogue on structural policy issues. APEC is a proper place for sharing and learning on SR and it has quite number of best practices on SR. Indonesia should utilize APEC best-practices in improving its domestic "behind the border" policies. Indonesia should take advantage from APEC capacity building activities, especially the tailor-made capacity building.

Restructuring of Institutions as Part of Bureaucracy Reform in Indonesia[1]

Staffan Synnerstrom and Erwin Ariadharma

Background

As has become increasingly recognized, the overall national civil service regime has been a significant impediment to the country's development ambitions and requires serious and sustained reform along several dimensions. These impediments include outdated mandates and weak coordination at the center of government for the management of the civil service, very rigid rules and procedures on ministerial and agency organizational structures and staff establishments that obstruct efficiency, and a civil service compensation and personnel management system that is outdated, highly detailed and rigid and that makes it difficult to attract, retain, and motivate high quality staff as well as to discipline non-performing staff.

The momentum towards Bureaucracy Reform (BR), has been steadily gaining strength over the past five years. The initiative began in late 2006 with reforms in the Ministry of Finance, with the Supreme Audit

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[1] This paper was presented by the authors at a CSIS roundtable on "Structural Reforms: Indonesia's International, Regional and National Commitments and Progresses," held on August 2, 2011, in Jakarta.

Board (BPK) and the Supreme Court following in 2007, and consisted of significant increases in civil servants pay through the inclusion of a parallel pay and grading structure (in addition to the national pay scale) as an implicit *quid pro quo* for restructuring, improved standard operating procedures and modernized human resources management practices. These agency-specific initiatives have now evolved into a national strategy and action plan for civil service reform with the approval, in December 2010, of the Grand Design of Bureaucracy Reform for 2010 – 2025 and the Road Map of Bureaucracy Reform for 2010 – 2014.[2]

The Grand Design and Roadmap formalize a mechanism for agency-by-agency rollout of reforms. It includes objectives for reforming national civil service practices, and outlines in great detail the implementation mechanisms for BR and the processes by which agency reform proposals will be evaluated. Specifically, each ministry or agency prepares a proposal for BR that covers several key dimensions, including agency organizational restructuring, streamlining and improving business processes, improving transparency and accountability, and modernizing human resource management policies and practices. The BR proposals are evaluated at the center of government by a National Bureaucracy Reform Team (through the National Bureaucracy Reform Management Unit) that reports to the Vice President of Indonesia. If proposals are deemed to be acceptable, staff in the vetted agencies will be given additional pay in stages as an incentive to improve performance. In 2010, another 11 agencies joined BR, and received pay increases through an additional pay scale, though smaller than that of the original three agencies. The aim is for the program to expand to all 74 central ministries and agencies by 2014, and eventually to all provincial and local governments.

This institutionalization of a national approach to agency-specific reforms, with high-level political ownership and oversight, is an important achievement for Indonesia in itself as in many countries agency reforms many times begin in the Ministry of Finance but fail to spread much beyond it. However, many implementation details remain to be worked out, in particular the development of a monitoring and evalu-

[2] Presidential Regulation Number 81/2010 and Minister of PAN & RB Regulation Number 20/2010.

ation framework for the reforms, and there remains a perceived gap between the rewards given to the BR agencies in increased pay and what has been concretely achieved in terms of reform results. Specifically, while the Ministry of Finance can point to improved customer satisfaction and better ratings in KPK's annual surveys (for example, in tax administration where both increased revenues and improved services are outcomes of the reforms), the perception shared by many is that these improvements did not warrant the considerable increases in pay that were given.

Addressing this credibility gap and ensuring that BR is successful requires tackling four major systemic challenges:

1. There are some changes that in reality cannot be done effectively at the agency level which means that agencies actually will be unable to achieve the reform goals they have identified in their proposals. One example of such limitations is the scope for organizational restructuring which is severely constrained by the lack of flexibility imposed by national regulations and a vetting process by MenPAN & RB on organizational structures and on-staff establishments.
2. Agency reforms have added to the complexity of the overall system, most visibly seen in the pay structure which has added additional layers to an already incoherent system calling for a restructuring of the pay and grading structure.
3. There has been, to date, no clear governance or M&E (Monitoring and Evaluation) mechanism to ensure that agencies that claimed to be reforming were actually reforming. Nor have there been any clear sanctions for non-reformers, such as for example withholding the pay increases.
4. The fiscal implications of pay increases for the BR agencies are considerable, and are presently being dealt with in an ad hoc, and therefore potentially unsustainable, manner with the 11 second round agencies receiving smaller pay increases based on a different pay structure than the original three BR agencies.

Drivers for Restructuring

Restructuring normally implies at least changed organizational structures, revised job definitions and changed staff numbers. In most

OECD countries, restructuring is a common change driven basically by three major drivers: to cut costs, to improve productivity and efficiency or to respond to international or national changes in the context in which an administration performs. Many countries have to contain the size of the administrative budget in relation to total expenditure, leading to rationalization and downsizing to finance e.g. wage increases to be able to keep their spending within the cap for the administrative budget. At the same time, new techniques enable sectors and institutions to rationalize thus enhancing efficiency and productivity and reducing costs at the same time. Finally the world around an administration evolves in a never ending process. New policy priorities emerge, such as e.g. climate change, and national or international developments may require different institutions, such as new developments within ASEAN or the expansion of the European Union. However, adding new structures in most OECD countries consequently requires removal or merging of old ones not to increase the ratio of administrative spending in relation to total spending.

In Indonesia, current drivers for restructuring are different. The most important driver in OECD countries, i.e. to restructure and rationalize to save or cut costs is at this moment not an issue in Indonesia. With the continued rollout of BR and BR allowances it may, however, well become an issue. The most important driver for restructuring in the Indonesian administration is thus not due to any external, political or fiscal pressure but in fact due to an internal desire to receive increased take-home pay, which may or may not be a strong motivation to reform. Although restructuring to improve the efficiency and effectiveness of service delivery lies at the heart of the BR approach, the prevailing regulatory constraints may hamper any meaningful outcome of such restructuring.

Main Issues

BR restructuring in Indonesian institutions faces specific regulatory and operational constraints. International experience suggest that if these constraints are not well identified and managed or removed, restructuring opportunities can be wasted and large expenditure can fail to achieve sustainable efficiency improvement. The current civil service regulatory framework, based on Law 8/1974 (amended by Law

43/1999), was a codification of the New Order regime's concept of the Indonesian civil service based on centralistic, highly detailed approach inspired by military practices that gave little flexibility for line ministries and agencies. Although Law 43/1999 aimed for a modernization of the Indonesian civil service, it failed to fully achieve this goal as new secondary or implementing regulations never were developed replacing the old secondary regulations issued under Law 8/1974. Therefore, most civil service policies and practices are still very much like they were 20 years, or even 40 years, ago. In spite of that most secondary regulations have been amended during the last ten years, practices have not changed much or at all.

Within this system, civil service organizational structures and staff establishments (*formasi*) are based on symmetric rather than operational considerations with a focus on balanced numbers of units and sub-units and a certain number of positions at each level rather than on what is needed operationally. As a result, agencies suffer from fragmentation of tasks as well as of decision-making powers since these are distributed among a large number of pre-defined sub-units. Another result of the current regulations is overstaffing in most institutions implying a both quantitative (too many units and sub-units and too many positions) and a qualitative (unqualified position holders) redundancy.

The aim of the current system and of MenPAN & RB's vetting process is to promote an organizational model and a level of staffing that should suit all institutions, i.e. in principle the same way structures and staffing are determined in combat forces. Reality is, however, that a model that aims to suit all civil service institutions in fact does not suit any of them.

It may be very difficult for a ministry or an agency to be able to achieve meaningful structural reform outcomes in the current rigid policy and regulatory environment. To be able to design and implement effective reforms rather than do window dressing to receive increased pay, ministries and agencies require some flexibility in determining the appropriate organizational structures and staffing levels based on function, operational tasks, size and workloads rather than on considerations of balance and symmetry. The issue of organizational restructuring is on the agenda in all reforming institutions with

the Ministry of Finance as the leading institution for such reforms. The current rigidity has, however, seriously impacted the Ministry of Finance's efforts to streamline organizational structures, improve staff quality and right-size entities. These reform efforts have either been very cumbersome (it took two years to get approval to set up a permanent Project Management Unit in DG Tax) or failed (DG Treasury still employs several thousand redundant staff). For BPK, it took two years to get approval for transformation of all structural Echelon IV positions into functional External Auditor positions and this list could be made much longer.

Finally, today staff costs in an institution are given costs that neither the institution, nor any manager within it can have any impact on. Consequently staff is not seen as one resource among others that need to be managed in a fiscally sound way and institutions do not care about the level of these costs. The current practices where MenPAN & RB approves staff establishments through an administrative procedure separate from the budget process reduces an institution's scope to manage and make more efficient their most important and, normally most costly, resource, i.e. its human capital.

Ways forward to increase the scope for restructuring in BR agencies

1. Replace or modernize the current regulatory framework related to organizational structures and staff establishments to provide for flexibility and operationally sound and efficient organizational structures. "One size does <u>not</u> fit all!"
2. Empower the respective line institutions to decide on their own organizational structures within a flexible framework and discontinue the practice where MenPAN & RB has to approve any changes of details in them.
3. Make staff costs part of the operational/program budget and let institutions keep the surplus when they manage to decrease staff costs. By making staff costs part of the operational budget, institutions and managers can have impact and the possibility to keep surplus by making wage funds fungible[3] will be an incentive for rationalization and meaningful reforms. At the

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[3] Meaning that funds allocated to cover staff costs can be reallocated for other purposes.

same time, the process where MenPAN & RB approves staff establishments would be discontinued.

4. Introduce a right-sizing scheme which would enable redundant staff to exit the civil service in a socially and economically acceptable way (*Ongoing WB study*).
5. Reform the pay and grading structure including a basic pay that represents a much higher ratio of take home pay and at the same time discontinue counterproductive allowances such as meeting allowances. At the same time and in parallel, reform the civil service pension system (*Ongoing World Bank studies*).
6. Reform the centre of government to create a modern policy making, monitoring and supporting centre of government instead of a centre promoting outdated policies and making decisions on various details in line institutions, like today. At the same time, empower management of line institutions to take on full employer responsibility.

Annex 1

Constraint	**Relevant regulation**
1) Without a national strategic approach, K/Ls lack clear direction on purpose of restructuring (to enhance effectiveness, efficiency or something else).	-
2) K/Ls lack authority to determine own structures and jobs. Presidential Regulations sets the maximum ratios for structural positions in Ministries for Echelon I to IV. Role and functions for Echelon I are further defined; restructuring is possible for Echelon II to IV positions with an amendment of the Regulation.	• Presidential Regulation No. 47/2009 on The Establishment and Organization of Ministries. • Presidential Regulation No. 24/2010 amended by Presidential Regulation 67/2010 on Position, Role, Function, and Organizational Structure of Echelon I

Constraint	Relevant regulation
3) Approval of K/L restructuring proposals & job requirements by MenPAN & RB can be slow and uncertain	• Government Regulations No.11/2002 on Procurements of Civil Service • Government Regulations No.54/2003 on Civil Service Establishments • Government Regulations No. 13/2002 on Structural Positions in the Civil Service • Government Regulation No. 40/2010 on General Functional in the Civil Service
4) Weak incentives and systems for K/Ls to develop and maintain efficient structures; risk of "revolving door" undermining right-sizing benefits.	-
5) Lack of cross-government guidance on severance options and procedures	-
6) Unclear rules on compulsory termination of civil servants for streamlining of government	Art 23, Law 43/ 1999 on Civil Service
7) Prohibition of lateral entry restricts access to high caliber staff from outside the civil service, due to the nature of Indonesian Civil Service which is closed and career based system.	Art 12, Law 43/ 1999 on Civil Service

Infrastructure and Financing in the Context of Avoiding Middle-Income Trap

Rajat M. Nag

Introduction

You may have heard the expression "the 21st century will belong to Asia." Given the region's enormous growth in recent decades, the idea of this Asian century is certainly feasible. But it is not preordained. Many Asian countries are still very poor, and many others are in danger of being caught in the so-called middle-income trap. So this is an opportune time to focus on the region's remaining – and large – development challenges, and what we can do to make this truly an Asian century.

The Middle-income trap

Asia today is in the midst of an historical transformation. If it continues to grow on its recent trajectory, it could by 2050, account for more than half of global Gross Domestic Product (GDP), trade and investment and enjoy widespread affluence. Per capita income could rise six fold to reach the global average and be similar to European levels of today. Some 3 billion additional Asians could become affluent by today's standards. By nearly doubling its share of global GDP from 27 per cent in 2010 to 51 percent by 2050, Asia would regain, to a large degree, the dominant global economic position it held some 250 years ago.

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This article is an edited version of his speech, delivered at a seminar on "Infrastructure and Financing in the context of Avoiding Middle-Income Trap," held at CSIS, Jakarta, on June 13, 2011

However, as I said, Asia's rise is by no means preordained. To reach its potential, Asia must deal with multiple risks and challenges. These include large inequities within countries, intense competition for finite natural resources, global warming and climate change, and in almost all countries, the overarching challenge of developing governance and institutional capacity. The challenge I will focus on today is avoidance of the middle-income trap.

The middle-income trap refers to the situation in which countries have grown for a considerable period to the middle income level, and then stagnated and not grown to advanced country levels. Countries caught in the middle-income trap are unable to compete with low income, low wage economies in manufacturing exports. At the same time, they are unable to compete with advanced economies. In other words these countries are unable to make a timely transition from resource driven growth, based on low cost labor, to knowledge and productivity driven growth.

The costs of falling into the middle-income trap are staggering. If today's fast growing Asian economies can break through that barrier, developing Asia's total GDP could reach $148 trillion by 2050, with per capita GDP of $38,000. If they cannot, total GDP in 2050 would reach only $61 trillion and per capita GDP would be only $20,300 – thus denying billions of Asians a life time of affluence and well being.

Given the huge opportunity costs involved, it is no wonder that there is now a rapidly growing literature on how the middle-income trap can be avoided. It is clear that Asia's march towards prosperity requires policy makers to undertake long term, bold and innovative efforts to sustain high levels of growth. In an increasingly connected world economy, these policies must internalize global and regional issues as well as national considerations. The policy matrix will differ by country but the contours are roughly similar.

The main factor determining failure or success will be the ability of countries to innovate and upgrade their production processes. This crucial shift requires flexibility in setting policy, and large investments in human capital and research and development. Relevant basic education must be available to all. In higher education, more investment in science and technology education is needed with a view to creating a skilled and innovative work force. At the same time, traditional

policies such as providing good physical infrastructure to deal with increasing demands and promoting new developments and advances in technology will continue to be critical.

Physical Infrastructure

Provision of adequate physical infrastructure is a necessary condition that each and every Asian middle income economy must meet to achieve high income status. It is easy to see why, although considerably more difficult to ensure it. Infrastructure provides the foundations of economic growth and improves access to services and opportunities. It enhances trade and investment by reducing the costs of doing business and promotes private sector development by creating markets.

Without road access, adequate lighting, clean water and sanitation, children find it hard to attend and complete primary school let alone secondary levels. Poor physical infrastructure also prevents farmers from improving productivity, marketing their produce better and earning higher incomes. Innovation and entrepreneurship will be hobbled by poor physical infrastructure. Middle income Asia has come a long way in providing basic infrastructure but more needs to be done, particularly in the light of climate change and rising expectations.

Physical infrastructure will play a critical role in meeting the challenges of massive urbanization. Between now and 2050, Asia will be transformed as its urban population nearly doubles from 1.6 billion to 3.1 billion. Asia's cities, which already account for more than 80 per cent of economic output, will be the centers of higher education, innovation and technological development. The quality and efficiency of urban areas will thus increasingly determine Asia's long term competitiveness and social and political stability.

The reality at present for too many countries, however, is one of inadequate shelter, clogged streets and power shortages. Clearly, more has to done through both provision and efficient management of new urban infrastructure. In supporting urban infrastructure, ADB places great importance on environment and sustainability. For this, we support sustainable urban infrastructure including water and sanitation, as well as sustainable transport investment. In 2008, for example, ADB established a Cities Development Initiative for Asia, which invests in

public transportation, methane capture from solid waste, energy efficiency in buildings, alternate energy sources, and eco-industrial estates and systems.

Physical infrastructure is also a key element in achieving higher levels of regional economic cooperation which offers the prospect of rapid growth and global competitiveness through increased connectivity and static and dynamic gains. ADB has taken a leading role in the promotion of regional economic cooperation and connectivity. The Greater Mekong Subregion program and the Indonesia-Malaysia-Thailand Growth Triangle were initiated almost twenty years ago and the ADB is proud to have been there at their birth and so closely associated with them over nearly twenty years.

We have also played a key role in the development of the Brunei Indonesia Malaysia Philippines -East ASEAN Growth Area, commonly called BIMP-EAGA. Our collective efforts are paying off as is demonstrated by the near completion of many multi country economic corridors crisscrossing mainland Southeast Asia. In the BIMP-EAGA, three ADB projects are now at an advanced stage of preparation: the Trans-Borneo Power Grid, the Pontianak-Entikong transport project link in Indonesia, and the Tanjung Selor border road project linking Indonesia with Malaysia. These and many other similar projects, together with bilateral or regional policy reforms which address issues underlying cross border movements, will play a critical role in the establishment of a connected and competitive ASEAN Economic Community by 2020.

Financing

The physical infrastructure which will be needed to ensure that Asian countries escape the middle-income trap will not come cheaply. The 2009 ADB publication 'Infrastructure for a Seamless Asia' estimated that the region would need $8 trillion in infrastructure finance through 2020 to support current levels of economic growth. Energy and electricity will take up about 40% of the total followed by transport at about 25% and social infrastructure for education, health, water and sanitation and other public goods another 25%.

Infrastructure is one of the core areas of operations under ADB's long-term strategic framework, *Strategy 2020*. During the 2007-2009 period, ADB's annual infrastructure lending averaged $7.2 billion or

65% of total lending. This is projected to increase to $9.3 billion per year by 2013. Lending for regional cooperation and integration will rise as well during this period from $1.4 billion a year to $2.0 billion. ADB has targeted public and private lending operations at the regional and subregional levels to increase to at least 30% of total lending by 2020. Although these sums are substantial, private sector participation including through public-private partnerships is still essential. We estimate that private investment will have to cover 40% of total needs. The majority of this still derives, however, from commercial banks. Equity developers account for about a quarter of financing while bonds may cover about 15%.

Given the immensity of needs for infrastructure development, mobilizing adequate finance remains a key challenge. But, in this, we are fortunate that Asian savings rates are exceptionally high. It is estimated that annual gross domestic savings in emerging Asia are close to $5 trillion. China and Singapore save over 50% of GDP a year while Malaysia, India and Thailand save over a third. So, how do we better use these savings for infrastructure developments? At ADB, we try to address part of this question, if not all.

Development of domestic capital markets and encouraging local currency lending will play a key role in tapping into the region's vast domestic savings. As you know, we have supported the ASEAN+3 Asian Bond Markets Initiative, which has been working to deepen domestic capital markets and promote local currency bond issues. This will also help address currency mismatches, a problem which hampers stable, long term financing. The new Credit Guarantee and Investment Facility, which was established by ASEAN+3 with ADB support, will also make it easier to promote public -private partnerships and obtain better financial terms.

Infrastructure funds can also channel Asian savings to help finance infrastructure projects. In 2008, we established the Asian Infrastructure Financing Initiative with support from the Republic of Korea and the Islamic Development Bank which have contributed $3.5 billion and $1 billion respectively, for both sovereign and private projects. Mention should also be made of the proposed ASEAN Infrastructure Fund which ASEAN and ADB are working hard to establish this year and which will significantly contribute to meeting the financing require-

ments of the ASEAN Master Plan for Connectivity.

Conclusion

I fervently hope that the Asian child who is born today can look forward to a long and prosperous life in the Asian Century. Her life will be immeasurably different from that of her grandmother or even mother. But Asia's future prosperity must be earned through pragmatic policy choices and sustainable investments in both human capital and physical infrastructure. The stakes are high and the sooner we address these challenges individually and collectively, the greater the assurance that this child will indeed live in the Asian Century.

Harnessing Global Diversity

Pascal Lamy

The topic of my intervention today is no stranger to Indonesia. With its more than 17 000 islands, its several hundred languages and dialects, its 300 ethnic groups, its religious diversity and its enormous biodiversity, Indonesia is a perfect reflection of our greatest challenge today: harnessing global diversity, weaving its strengths, managing its challenges.

Globalization dominates our era, but it is an increasingly fragile dominance. Even as global integration delivers enormous benefits — growing wealth, spreading technology, improvements for of billions of people in the developing world — it also creates new risks — financial instability, economic imbalances, environmental stresses, growing inequalities, cyber penetration — that we seem to have difficulty managing.

Markets and technology are pushing us together, but political pressures — economic insecurity, resurgent nationalism, global poverty and power shifts — risk pulling us apart. An integrated global economy requires political consensus and cooperation to sustain it. But nations and societies appear increasingly uneasy with a world seemingly on steroids that they feel powerless to control—and international co-operation is under strain. Is globalization outpacing — even undermining — our ability to manage it?

This is not a new concern. Since the industrial revolution, market capitalism's power to generate both incredible progress and enormous

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This article is an edited version of his speech, delivered at the 2011 Panglaykim Memorial Lecture in Jakarta on June 14, 2011.

disruption — what Schumpeter called "creative destruction" — has preoccupied governments. And globalization is nothing if not the worldwide technology-driven spread of market capitalism — a process that has been unfolding, in fits and starts, for three hundred years.

Karl Marx was wrong about a few things, but he was surely right about capitalism's inherent tensions and contradictions. "Capitalism has created more massive and more colossal productive forces than have all proceeding generations together", he wrote in 1848, but it also represents the "uninterrupted disturbance of all economic and social conditions, everlasting uncertainty and agitation". The same forces that explain market capitalism's power to transform economies — innovation, risk-taking, competition, the survival of the economically fittest — also explain its power to disrupt, overturn, breed social insecurity and conflict. Market capitalism, Marx fatalistically argued, contains the seed of its own destruction.

A century later, Karl Polanyi used similar arguments to explain why the open economy of the XIX century suddenly collapsed in the early XX century — overtaken by war, economic depression, and totalitarianism. Open markets need social and political cohesion to work, he argued, but paradoxically free markets, left unconstrained, soon undermine this cohesion. Individualism and competition are rewarded — but at the expense of equality and community. Labour and capital flow freely to where they earn the most—but capital becomes divorced from production, and individuals become strangers in a strange land. New winners are created — but the losers feel threatened and alienated. The result is a backlash against market capitalism among those trying to protect themselves from its harsh effects, the erosion of social and political cohesion, and the rise of insecurity and division.

One can disagree with the details of his argument, but it is hard to dismiss his basic insight: by transforming the economic and social order, globalized market capitalism also risks weakening, even destroying, the political foundation on which it rests. His answer was not Marxist revolution, but political evolution—re-embedding markets in a reinvented social and political order.

The catastrophic end of the XIX century's version of globalization offers a cautionary tale for our age. On many levels — the flow of capital and goods, the ease of transportation, the advent of new trans-

port and communications technologies — international integration approached — and in some ways surpassed — the level of globalization we have reached today. Labour flows were actually freer, as tens of millions migrated to the Americas, Africa and Australia without passports or immigration papers. International finance was anchored to the gold standard, linking the world together in a single monetary order. It was an age dominated by the idea that global markets are self-regulating, unstoppable, and should be left unfettered. It was also a time of great optimism — the so-called "Age of Progress".

Not only did the world economy grow more in 75 years than in the previous 750, but the circle of growth was expanding dramatically — to new economic powers in Europe, in North and South America, and in Asia and Africa. New innovations — from railways, to telegraphs, to steamships — seemed to promise a world increasingly and irreversibly linked together in prosperity and peace. The optimism about globalization's inevitability was captured by Norman Angell's *The Great Illusion* in which he argued that economic interdependence had made armed conflict between nations impossible and obsolete. His book came out just four years before the world plunged into the nightmare of the Great War.

What went wrong? Beneath the progress of this first age of globalization, problems and tensions were building. The rise of new economic giants, especially Germany, dramatically shifted the balance of power and made the old giants uneasy — prompting new defensive alliances, an arms race, and a scramble for colonial spheres of influence. New economies began to flood Europe with cheap agricultural products — threatening farmers' livelihoods but benefiting the working poor — while rapid industrialization increasingly divided politics along class lines. Nationalism was on the rise in Europe; ethnic conflict was sweeping the Balkans and Middle East; domestic pressures were mounting to turn inwards, abandon open trade, and block immigration. Many sparks ignited the First World War — as any schoolbook can tell us — but the one unifying cause was the disintegration of international trust and the breakdown of political cooperation. It took thirty years — through two World Wars and the Great Depression — for the world to begin to rebuild the economic system it had lost.

What made it possible was the emergence of a new political consensus after the Second World War. Central to this new order was the leadership of the United States, the undisputed economic and political hegemon. A system of only one power, an "empire", is the easiest international system to coordinate and in the post-war era the United States was "the One". American isolationism had been one of the principal causes of the international system's weakness between the wars. Now the United States not only had the muscle to underwrite a new international economic system, but it had — along with Britain and other allies — a remarkably clear vision of what was needed, based on a shared assessment of the successes and failures of the past.

A key objective at that time was the return to open international trade and financial stability — since the protectionism and financial chaos of the 1930s were widely seen as root causes of the war. Another objective was to underpin this integrated world economy with powerful new international institutions — the IMF, the World Bank, and the aborted International Trade Organization (which became the GATT) — to channel and reinforce international cooperation. This was in marked contrast to the XIX century's faith that global free markets best regulate themselves alone — requiring only periodic "crisis" meetings of the Great Powers. A third objective was to cushion the effects of openness and integration by ensuring that national governments retained the ability to "manage" demand (and thus employment), provide social insurance, and pursue redistributive policies — on the assumption, again learned from past mistakes, that economic openness and integration would be supported domestically, only if its benefits and costs were more equitably shared.

So the new international economic system both resembled the old order and was radically different. Trade was now to be progressively opened multilaterally — not just bilaterally — and regulated by the GATT's international rules. The Bretton Woods institutions moved to the centre of the financial system — in charge both of overseeing the fixed exchange rate and of managing adjustments. Against the XIX century belief that economic integration — and especially maintaining the gold standard — took precedence over national monetary and fiscal flexibility, and limited the scope for social redistribution, the post-war international economic system rested on ambitious and far-reaching na-

tional social systems — whether America's New Deal, or Britain's welfare state, or Europe's social democracy. As John Ruggie argued, it represented a system of "embedded liberalism" — a global balance between openness and regulation, capital and labour, markets and society.

Although the post-war economic order succeeded spectacularly, it is now being eclipsed by globalization. An early casualty was the Bretton Woods system of fixed exchange rates. Monetary stability encouraged investors to expand their financial activities across borders -gradually integrating financial markets. Financial integration, in turn, weakened the capital controls needed to operate the fixed exchange rate system — and interfered with governments' ability to maintain independent monetary and fiscal policies. Forced to choose between free capital movements, national macroeconomic independence, or fixed exchange rates, the US abandoned the latter in the early 70s — and the world has moved towards a free global capital market ever since. In the post war era, capital controls were almost universal; now 3.7 trillion dollars — one twentieth of the value of the world economy — is traded across borders every day. The sheer scale of these transactions—and the exotic financial instruments in which they are now packaged and repackaged—makes it increasingly hard to understand the international financial system, let alone regulate it. We are a long way from Bretton Woods!

Less dramatically, the world trading system is also being overtaken by events. The massive reductions in border tariffs — from over 40% on average in 1947 to less than 6% today — have exposed deeper structural differences between economies — in food standards, industrial policies, or legal systems — that are generating new "system frictions". Subjects that were never given much consideration when the GATT was created — such as environmental sustainability or resource scarcity — are of growing concern to an interdependent world — but to a large extent beyond the scope of existing trade rules.

Even more challenging is the need to match an increasingly open world trading system with greater international fiscal and monetary coordination. Global macroeconomic imbalances were a major cause of the recent financial crisis. But the macroeconomic adjustment which conventional wisdom says is needed to reduce surpluses in Asia, and reduce deficits in America — has barely begun.

This adjustment challenge is made harder because of the growing pressure on national social systems and policies. The post-war welfare state was designed for a more static economic world less exposed to external forces—not for a world where, for example, trade as a share of US GDP has grown from less than 10% in 1970 to over a quarter today.

The sense that social programmes and labour laws were becoming outdated, even counterproductive, in a globalizing economy—more social hammocks than social safety-nets or springboards—only reinforced growing calls, especially in the Thatcher and Reagan era, to dismantle the "nanny state", cut taxes and roll back government. Some even made a virtue of the way global integration allegedly limited governments' freedom to advance social goals— Thomas Friedman describing globalization as a "Golden Straightjacket".

The previously discredited XIX century idea that a government's job was to free up markets—and stay out of their way—was back in vogue as the "Washington consensus". And the post-war social contract between international economic openness and domestic social support was breaking down.

Perhaps the biggest change is globalization's impact on the geopolitical landscape. Globalization has both enabled — and rewarded — a shift in production, investment and technology to emerging economies. The result — as Martin Wolfe put it recently — is that the periphery is becoming the core and the core is becoming the periphery. The US remains a key player but it is no longer dominant. Fast-rising powers, like China, India, Indonesia and Brazil, play a role that was unimaginable even twenty years ago — while smaller developing countries want a say in a system in which they have a growing stake. The simple — even simplistic — North-South divide has given way to a more complex world of many different Souths and many different Norths. This multipolar system is much more "democratic" than the old post-war order. The days when a single or a few countries could design and direct the international system are gone. Yet the old powers are reluctant to share centre stage — and worried about decline — while the new powers are timid in sharing responsibility.

Make no mistake: globalization is a revolutionary force – more revolutionary even than its XIX century predecessor. The world eco-

nomy is eight times larger than it was in 1950 — and world trade has expanded 33 times since then. Two decades ago, the web did not exist. Now 2 billion people — a third of humanity — use the internet every day; four billion people have mobile phones; 1 in 12 has a Facebook account. It now costs less to ship a container from London to Shanghai than from London to Birmingham. Two hundred million people — almost the size of Indonesia— are currently migrants in foreign countries, integrating the world socially and culturally, as well as economically. Over 3 billion people—in China, India, Indonesia and other developing countries—are achieving in a generation what it took the West a century or more to achieve. This alone stands as the most significant economic event in history. It is because of our open and interconnected world – a world on fast-forward -that material wealth is spreading, knowledge is expanding, health is improving, and the walls dividing us are falling down. This "one world" would have been unrecognizable to the Cold War generation, and unimaginable — even utopian — to those who lived through the nightmare of two World Wars.

Yet for all our successes, globalization remains a discontented dream. The recent financial crisis—and the "Great Recession" which followed—was merely the most cataclysmic in a series of global financial shocks that included the collapse of the ERM in 1990, the peso crisis in 1995, the Asian crisis in 1997, the Russian crisis in 1998—and may include Europe again if sovereign debt problems cannot be resolved. These have taken place against a background of growing fears that foreign competition is hollowing out industries and off-shoring jobs; that footloose corporations are under-cutting environmental and labour protection; that jet travel is spreading disease; that shrinking borders are blurring identities and cultural values; and that rising economic powers threaten security and peace.

Many of these fears are irrational—or worse. But this does not change the fact that millions of people are increasingly worried about unemployment and inequalities, about the health of the planet, about the safety of their children's food— and are questioning whether the benefits of globalization outweigh the risks. A recent poll suggests that only a third of Americans now view globalization positively — a far cry from the optimistic mood that greeted globalization at the end of the Cold War. Another poll found that only 37% of Europeans viewed

globalization as an opportunity, while almost half saw it as a threat. Even more worrying are the signs that virulent nationalism and racism are on the rise, and that support for immigration, multiculturalism, and religious tolerance is under strain. We are experiencing what Freud called a "civilizational discontent". And this discontent is increasing the pressure on governments to turn away from multilateral cooperation and openness in favour of more narrow interests.

So is it back to the future? Are we in danger of repeating the mistakes of the XIX century? Or is there an alternative? In his latest book, a rare piece of high quality on global issues, Dani Rodrik argues that we have to face up to the incompatibility between democracy, globalization and sovereignty of the nation-state. He argues that we have to renounce one of these three. Others go further and advocate "deglobalization"; that we have to turn back on globalization.

My own view is that deglobalization will not and should not happen. It will not happen because its shaping factors are here to stay, maybe leading to a slower globalization. The main engine of globalization is technological progress. This has never regressed in human history. True, another factor, the huge expansion of global finance, may abate as new rules to deleverage the financial industry and to limit risks will reduce the excessive profit margins that ignited the financial crisis. True, environmental constraints may increase the preference for proximity sourcing of goods and services, although this may not result in an optimal allocation of scarce resources, such as water. But, overall, I do not believe that the clock can be turned back. Nor do I believe such a course would be desirable.

Would any of the major global problems we face — from pandemics, to nuclear proliferation, to climate change, to economic imbalances — be easier to solve? Should emerging economies also slow their participation in globalization if America and Europe decided to opt out? Are we going to switch off the over 40 million Indonesian internet users? Or the over 30 million Indonesian Facebookers? Should jet travel or global supply chains be rolled back? And are people — for all their discontents — really willing to forego the benefits that flow from more trade, more investment, more communication, the spread of knowledge and ideas? Withdrawing from globalization — or severing interconnectedness — will not restore employment or rebuild in-

dustrial strength or re-inflate the sub-prime housing market. If the collapse of the XIX century's economic order teaches us anything, it is the disastrous consequences of turning inwards, acting unilaterally, and giving in to the politics of insecurity and fear.

The essential problem today is too little governance of globalization. Our institutions, policies, and mind-sets have not caught up with the integrated and interconnected world we have created. The first age of globalization fell apart because there was no effective political or policy response to profoundly changing economic and social conditions. In the same way, the underlying weakness in today's economic order is fundamentally political.

Stating the problem is the easy part — providing answers is more difficult — and implementing them, more difficult still. One challenge is to reinvent international institutions — once universally idealized, now almost universally disparaged. Replacing the G8 with the G-20, which includes emerging countries like Indonesia, was an important step — an acknowledgment of today's multipolar world, and a tangible sign that the system can reform and adapt. And the G-20 is not the only innovation. From managing SARS and deforestation, to writing technical rules and accounting standards, to tracking illegal drugs and terrorists — international cooperation has never been so wide or so deep.

But this is clearly insufficient. And reinventing our institutions is not about building more agencies and more vertical silos. It is about "networking" institutions in a better way — ensuring that the WTO, the IMF, the World Bank, and the vast UN system operate as a more coherent whole, not a medieval patchwork of fiefdoms.

This leads us to the challenge of policy coherence. As the world has grown more integrated, policy lines have become blurred — and policy-making has become more complex.

WTO negotiations, for example, focus mainly on cutting tariffs or limiting subsidies. But these issues are increasingly impacted — even overshadowed — by shifting patterns of trade, new centres of production and competition, and volatile financial flows and exchange rates.

The way we measure trade today, for example, does not reflect any more the reality of trade flows. It was fine when a country used to produce finished goods and export them to another country. But today,

a large part of trade flows are in intermediate goods or services. Hence a huge amount of double counting.

If we want numbers to properly reflect the reality of "Made in the World", we have to switch to a value-added measure, as we do for GNP.

In the same way, climate change negotiations are not just about the global environment but global economics as well — the way that technology, costs and growth are to be distributed and shared.

Likewise, efforts to integrate poorer countries into the global economy have to focus on the complex challenge of building national capacity — helping countries to help themselves — not just ensuring that they conform to trade or financial rules.

These are not just global problems. It is easy to forget at the international level — when the right hand doesn't always know what the left hand is doing — that the same national governments are members of all international organizations. Policy coherence – ultimately – begins at home.

An even bigger challenge is to strengthen the global system's legitimacy—by better reflecting societies' hope and fears, interests and concerns. This starts with designing domestic policies for an age of globalization—helping sectors and workers adjust to global change; investing in education and training so individuals are empowered to take advantage of a more skills-and ideas-rich economy; and by better sharing the benefits—not just the burdens—of globalization. The debate about whether job losses are the result of trade or technology misses the basic point that people need more creative and effective help in adjusting to massive economic change— regardless of the causes. This is true for developed countries. Even more true in emerging countries where the speed of growth generates wider inequalities and where the construction of redistribution-based welfare systems takes time and needs to overcome powerful vested interests. As the architects of the postwar system realized—but our generation risks forgetting—people will support economic opening and integration only if everyone is benefitting from it.

Legitimacy also depends on democratising global governance—giving citizens greater ownership of the system and a greater say in its direction. Presidents and prime-ministers, congressmen and parlia-

mentarians, trade unions and civil society movements, need to engage more actively in global issues and institutions. And global institutions need to be held more accountable to national parliaments and voters. Instead of globalizing local issues, we should be localizing global issues. This is not utopian. The Internet, Facebook, and CNN or Al Jazeera are already creating the outlines of a global audience, global public opinion and — increasingly — a global sense of right and wrong from disparate cultures and communities throughout the world. Our shocked reaction to the Indonesian tsunami in 2004 and more recently the Japanese one, our revulsion when the Egyptian police opened fire on protesters, our collective joy when Chilean miners were rescued – these were expressions of a new democratic energy that can be harnessed behind global and local policies. We must respond to the very human need for belonging, roots, and community—not by blending or erasing cultural differences, but by tapping into them. Too often globalization feels like the internet—everyone connected but no one in control. Too many people today feel powerless -and powerlessness poisons democracy.

This brings me to the importance of political leadership. Half a century ago, the architects of the post-war system were motivated by a simple and powerful idea — that a world based on freedom, openness, and shared prosperity offered our best chance for lasting peace. But the end of the Cold War produced no similar new vision. On the contrary, the Soviet collapse tended to reinforce the *status quo*. It encouraged the belief that we had reached the end of our policy debates — if not "the end of history". And that foreign policy could take a back seat to more pressing domestic concerns. The result is a certain complacency — or, worse, paralysis — in the face of globalization. An uneasy awareness of looming challenges, yet an inability to marshal the collective vision and will to tackle them.

World leaders need to explain the future to the present—which takes political courage at a time when globalization is being attacked from extreme Left and extreme Right. They need to show how national interests are increasingly global interests; how our security hinges on the security of others; how international cooperation increases sovereignty, while isolation diminishes it. The days when one power — even a United States or a China — could solve its financial, environmental

or even security interests unilaterally, without the help of others, have gone forever. We are — quite literally — all in this together.

Let me leave you with this thought. The real challenge today is to change our way of thinking—not just our systems, institutions or policies. We need the imagination to grasp the immense promise—and challenge—of the interconnected world we have created. The future lies with more globalization, not less -more cooperation, more interaction between peoples and cultures, an even greater sharing of responsibilities and interests. Multilateralism may be messy, frustrating, two steps forward and one step back, as we know only too well in the WTO. But the fiction that there is an alternative is naïve and dangerous. Naïve because it ignores that we are becoming more — not less — dependent on one another. Dangerous because it risks plunging us back into our divided past — with all of its conflicts and tragedies. It is too often tempting for politicians to mobilize proximity, which roots belonging and identity against "the others", the "foreigners".

To quote Indonesia's national motto, *"Bhinneka Tunggal Ika"* - it is "unity in our global diversity" that we need today.

Electoral Governance and Democratic Consolidation in Indonesia

Ben Hillman

Introduction

Since returning to democracy in 1999, Indonesia has introduced direct elections for president, national and sub-national parliaments, and local government executives. While all of these elections have been successful from a number of perspectives—e.g. high voter turnouts, low levels of violence and the peaceful transfer of power, they have also been marred by serious shortcomings in electoral governance. During parliamentary and presidential elections in 2009 and local executive elections in 2010 problems appeared at every stage of the election process from voter registration through to vote counting. Millions of eligible voters were found to be omitted from electoral rolls while thousands of ineligible voters were included in the lists. Forty two of Indonesia's 44 competing political parties filed complaints over vote counting, prompting *Kompas*—Indonesia's leading newspaper—to declare the April 2009 parliamentary elections to be the worst since 1999 (*Kompas* 2009).[1] The presidential elections that followed in July resulted in 722 petitions to Indonesia's Constitutional Court. Local exe-

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[1] 'Manajemen Pemilu 2009 terburuk' (Management of 2009 general elections the worst), *Kompas*, 11 April 2009.

cutive elections in 244 regions in 2010 generated 215 disputes over elections results to be heard by the Constitutional Court as well as 1,636 reports of administrative violations implicating election officials. The persistence of such problems in Indonesia's elections undermines the perceived fairness and legitimacy of the electoral process and efforts to consolidate democracy.[2]

Understanding the reasons for the decline in the quality of electoral governance is important for policymakers in Indonesia and in other newly democratizing states. So far election analysts have tended to blame failures in electoral governance on the low capacity of Indonesia's General and Local Elections Commissions.[3] This view is shared by the media, politicians, political party representatives and civil society groups in Indonesia. In 2009 two of the three largest political parties threatened to sue Indonesia's General Elections Commission for administrative violations—while a consortium of NGOs filed a citizens' law suit against it.[4] Others called for election commissioners to step down or be put on trial.[5] In recent local executive elections, governance failures have undermined public confidence in election results and led to violence. In Kupang, Eastern Indonesia, protestors demanded the dissolution of the Local Elections Commission. One person died during the violence surrounding local elections in Tana Toraja, South Sulawesi where angry protestors attacked the offices of the Local Elections Commission and set fire to ballot boxes in 19 out of 23 sub-districts.[6] A recent study suggests that much of the violence could have been prevented by better electoral management.[7]

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2 Interview with Election Oversight Committee Member, Wahida Suiab, Jakarta, 9 November 2010.

3 Gumay, Hadar and Stephen Sherlock, "Local Executive Elections: Policy Lessons for Electoral Administration and Democratic Governance", paper presented at the Australia Indonesia Governance Research Partnership Policy Research Forum, December 2007 (Jakarta: Indonesia); and Rizal Sukma, "Indonesian Politics in 2009: Defective Elections, Resilient Democracy", *Bulletin of Indonesian Economic Studies*, Vol. 45, No. 3, 2009: 317–36.

4 Nugroho, I.D., "Election results legally challenged", *Jakarta Post*, 15 April 2009.

5 Wisnu, Andra, "Bring KPU members to court, analysts say", *Jakarta Post*, 7 July 2009.

6 Violence was reported in as many as 10 per cent of local elections held in 2010, an increase in violence from previous local elections. For a more detailed treatment of violence during local executive elections in 2010 see International Crisis Group, *Indonesia: Preventing Violence in Local Elections* (2010).

7 International Crisis Group, *Indonesia: Preventing Violence in Local Elections*, Asia Report N°197 – 8 December 2010.

While it is clear that Indonesia's General and Local Elections Commissions have been overwhelmed by the scale and complexity of organizing elections in a country that has the world's second largest number of registered voters, this article argues that the analytical focus on the administrative capacity of Indonesia's elections commissions overlooks more important institutional factors for the declining quality of electoral governance in Indonesia. Using local executive elections as a prism for analysis, this article examines the institutional framework for organizing elections in Indonesia. It argues that overlapping responsibilities between electoral management bodies and the dependence of the elections commissions on executive government resources and processes are the major obstacles to improving the quality of electoral administration and election-related dispute settlement in Indonesia. Findings are based on interviews with national and local election officials, legal analysis and on participant observation. While the focus of this study is electoral governance in Indonesia, the analysis will be of interest to students of democratization and democratic institutions in other parts of Southeast and East Asia.

Local Executive Elections in Indonesia

The introduction of direct elections for heads of government was a critical step for democratization in Indonesia because post-Suharto reforms included the decentralization of extensive powers from central government to local governments, particularly at the district (*kabupaten*) and municipality (*kota*) level.[8] Decentralization itself was seen as an important complement to democratic reforms, first by diffusing the concentration of political power at the center, and second, by placing decision-making closer to the people. The initial decentralization law (Law on Regional Autonomy No. 22 1999), however, did not provide for full local democracy. Instead it transferred the power to appoint local heads of government from the President to local parliaments. Under the Regional Autonomy Law provincial parliaments would appoint provincial governors, district parliaments would appoint district

[8] Under the Law on Regional Autonomy, the central government reserved exclusive jurisdiction over defence, national security, foreign relations, law enforcement, monetary and macroeconomic policy and religious affairs, while residual powers of government were devolved to sub-national levels. By concentrating powers at the district level, the law essentially bypassed provincial government.

heads (or regents, as they are sometimes known) and municipal parliaments would appoint local mayors. Such arrangements, however, failed to appease democracy activists and citizens' groups, many of which argued that a stronger system of checks and balances was needed to ensure the responsiveness and political accountability of the newly empowered local governments.[9]

In response to mounting public pressure, in 2004 the central government enacted a new law on regional administration (Law No. 32/2004). In addition to clarifying local government powers, this law introduced for the first time direct elections for heads of local government—provincial governors (*gubenur*), district heads (*bupati*) and town mayors (*walikota*).[10] Direct elections for heads of local government (Pilkada, Pilkada-sung, Pemilu Kakada) began in 2005, one year after Indonesia held its first direct presidential election. Since then each of Indonesia's 33 provinces (*propinsi*) and 502 districts (*kabupaten*) and municipalities (*kota*) has held elections for local executives at least once. In 2010 local executive elections were held, in most places for the second time, in 244 regions—seven at the provincial level and 217 at the district/municipality level.

The electoral mechanism introduced for local executive elections is essentially the same as that for presidential elections. It is a two-round or run-off system designed to ensure that the winner receives more than 50 per cent of the total vote. Candidates for heads and deputy heads of government compete in pairs at each level. A candidate pair wins the election outright if they receive more than 50 per cent of votes. If no candidate pair receives more than 50 per cent of the vote, then the candidate pair with the highest number of votes is declared the winner as long as their share of votes is higher than 30 per cent. If no candidate pair wins more than 30 per cent of the vote, then the candidate pairs with the highest and second highest number of votes contest a run-off

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[9] Aspinall, Edward and Greg Fealy (2003) *Local Power and Politics in Indonesia: Decentralisation and Democratisation* (Singapore: Institute of Southeast Asian Studies).

[10] The establishment of direct elections for local heads of government in Law No 32/2004 was based on a 2002 amendment to Indonesia's 1945 Constitution. Art. 56 Section 1 states that "Regional heads and deputy regional heads standing as candidate pairs are to be democratically elected by secret ballot in a manner that is direct, open, honest and just" *Kepala daerah dan wakil kepala daerah dipilih dalam satu pasangan calon yang dilaksanakan secara demokratis berdasarkan asas langsung, umum, bebas, rahasia, jujur dan adil).*"

election. All other candidate pairs are eliminated prior to the run-off. However, in at least one locality, local elections officials have declared a result even though no candidate pairs won more than 30 percent.[11]

According to eligibility requirements, candidates must be nominated by a political party or coalition of political parties that together represent at least 15 per cent of the seats in the legislative assembly at the same level, or that received at least 15 per cent of total votes in the preceding general (legislative) elections. In the first rounds of Local executive elections there were no legal provisions for independent candidates. However, in 2007 a decision by Indonesia's Constitutional Court paved the way for independent candidates to contest future elections.[12] The participation of independent candidates will make local executive elections more competitive, but they will also make elections more administratively complex because independent candidates must meet stringent nomination criteria—collecting endorsement signatures from as much as three per cent of the population in each province or district. In Aceh special autonomy arrangements allowed for the participation of independent candidates in the 2006 elections for heads of local government, a precursor to the Constitutional Court decision that allowed independent candidates to contest all local executive elections. Verifying the accuracy of nomination lists for independent candidates' proved so difficult for the Aceh Independent Election Commission that commissioners gave up trying to do it thoroughly, deciding that all candidates who had provided the minimum number of signatures had met the requirement.[13]

Organizing Local Executive Elections: the Role of Indonesia's Local Elections Commission (KPUD)

Legislation governing local executive elections initially placed local elections within the regional autonomy framework (i.e. outside the electoral framework governing Indonesia's general and presidential elections). This meant that during the first round of local executive elections the central elections commission did not have the authority to

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[11] This happened, for example, in Western Seram District in North Maluku.

[12] Constitutional Court decision No 5/PUU-V/2007, 23 July 2007.

[13] Hillman, Ben "Democracy and Peace-Building in Aceh: Report on Aceh Local Elections", United Nations Development Program, Indonesia, 2007.

oversee implementation of local executive elections. This led to a high degree of variation in the quality of local executive elections across the archipelago. Indonesia's Regional Autonomy Law (No. 32/2004) also placed the KPUD under the direct control of the local parliament (DPRD) during the implementation of local executive elections—a move that seriously compromised the electoral management body's independence. However, following a judicial review of the institutional arrangements, a new Law on Election Administration (No. 22/2007) placed the KPUD under the direct supervision of the national elections commission rather than the local parliament. While the local elections commission would retain primary responsibility for implementing local executive elections, the role of the central elections commission would be to formulate uniform national guidelines and to supervise and monitor the elections.[14]

According to Law No 22/2007 article 9 (3), the primary responsibilities of the local elections commission are to:[15]

a. design the program, budget, and schedule of elections;
b. prepare and establish technical guidelines for each stage of the election;
c. coordinate, implement, and control all stages of implementation;
d. update the voters' data based on population data and finalizing the voter's register;
e. verify pairs of candidates;
f. confirm and announce results of the count;

[14] Other relevant laws are: Law No 12/2008 on the Second Amendment of the Regional Governance Law No. 32 of 2004; Law No. 8/2005 on the Enactment of the Government Regulation in Lieu of the Law No. 3/2005 on the Amendment to the Law No 32 of 2004 regarding the Regional Government to become a Law; Law No. 1/2004 on the State Treasury; and Law No 33/2004 on the Fiscal Balance between the Central Government and Regional Governments. Important government regulations with reference to Local executive elections include: Government Regulation in Lieu of Law No 3/2005 regarding the Amendment to Law No. 32/2004 regarding the regional government; Government Regulation No 6/2005 on the Election, Approval, and Dismissal of the regional head and the regional deputy head; and Government Regulation No. 17/2005 on the Amendment on the Regional of the Government of the Republic Indonesia No. 6/2005 regarding the election, approval, and dismissal of the regional head and the region deputy head.

[15] The law specifies duties for KPUD at the provincial, district and municipal level. An abridged version of KPUD duties is provided here for convenience. For precise wording, readers should consult the relevant legislation directly.

g. prepare an official report on the vote count and provide a certificate of the results to witnesses representing candidates, Panwaslu, and KPU;
h. confirm and announce the result of the election;
i. report the result of the election to KPU;
j. follow up irregularities reported by Panwaslu;
k. suspend temporarily or impose administrative sanctions on any members of the KPUD or secretariat who have not acted in accordance with laws or regulations; and
l. submit reports on the result of the election to the DPRD and head of government.

The capacity of the KPUD to discharge its duties impartially and efficiently has been a continuous target of public criticism in Indonesia. While blame is often placed on the capacity of staff recruited to organize elections, findings from this study suggest that more attention should be given to underlying institutional arrangements. Many of the "capacity" problems in electoral administration can be attributed to the structure of the KPUD and the agency's dependency on local government. While KPUD are designed to serve as independent election management bodies, in the implementation of local executive elections, their independence is compromised by several factors, including: (i) the method of recruitment of KPUD commissioners; (ii) the structure of the KPUD secretariat; (iii) finance and budgeting systems; and (iv) the role of the local government executive. Each of these factors is examined in turn below.

Local Election Commissioners

Much of the scholarly and journalistic criticism of electoral management in Indonesia has focused on the competencies of election commissioners.[16] Each local election commission (province, district and municipality) consists of a board of five commissioners elected for five-year terms. Candidates for commissioner positions generally have backgrounds in academia, civil society and/or religious organizations. In some cases commissioners have backgrounds in private business. Candidates are ineligible if they have been a member of a political party

[16] Rizal Sukma, 'Indonesian Politics in 2009: Defective Elections, Resilient Democracy'.

during the previous five years. Candidates are screened by a selection team consisting of five members, one of whom represents the government executive, two of whom represent the DPRD, and the other two of whom represent KPU. After screening for eligibility, the selection team prepares a shortlist of 10 candidates. For provincial KPUD positions, the list is submitted to the central elections commission. The list of candidates for KPUD at the district and municipal level is submitted to the provincial KPUD. The higher level election commission then selects the final five commissioners.

While the transparency of the selection process is commendable, several weaknesses in the commissioner recruitment process compromise the capacity and integrity of the KPUD. To begin with, the office of KPUD commissioner is not considered to be one of high status within the public service. Neither is it well remunerated. This makes it difficult to attract qualified and capable candidates. It also makes KPUD candidates more vulnerable to official corruption. Research has uncovered examples of candidates for political office promising KPUD members positions in the future government in return for their 'support'. Such "opportunities" are also blamed for attracting candidates with the wrong motives such as those who seek to use the role as a means of launching their own political careers. This occurs because local government retains a high degree of influence over the selection process. Even though KPU makes the final selection, the initial screening is conducted by a selection team appointed by the government executive and political parties within the DPRD. When an incumbent is running for a second term, election commissioners nominated by the local governor, mayor or district head can be susceptible to political pressure. One former provincial election commissioner and a former district election commissioner related to the author their personal encounters with such unsolicited pressure.[17] This potential problem is compounded by the fact that local government controls the budget for local executive elections—a separate issue compromising the operational autonomy of KPUD that is discussed in more detail below.

The timing of commissioner recruitment is another problem affecting the capacity of KPUD to discharge its duties effectively. The

[17] The identities of the two election commissioners are necessarily concealed.

duration of a KPU term of office is five years, which is aligned with the five-year terms served by local and national assemblies. This means that appointments are not aligned with local executive elections, which, unlike legislative elections in Indonesia, are staggered. Sometimes this means that KPUD commissioners are recruited just before local executive elections, leaving them little time to learn the ropes. This problem is compounded by the fact that new KPUD commissioners often have little or no election experience. In many other countries, the recruitment of lawmakers is staggered in order that the commission retains institutional memory.

The Structure of the Local Election Commission's Secretariat

While KPUD commissioners are responsible for general oversight of the process, the actual business of implementing local executive elections is carried out by the KPUD secretariat—a fact which is often overlooked by election critics, particularly political analysts within the Indonesian media. In accordance with the law, KPUD secretariats at the provincial level must consist of three divisions, each with two subdivisions, while KPUD secretariats at the district/municipality level must consist of four subdivisions. The uniform organizational structures imposed on the KPUD result in secretariats that are not always organized in a manner best suited to operational needs. In some cases, a minority of staff in one subdivision end up shouldering a majority of the work while staff in other divisions have little to do.

A further ongoing challenge is the election commissions' ability to recruit and retain high quality staff. While criticism of KPUD staff calibre has largely focussed on the commissioners, capacity is also a problem within the secretariat. While each KPUD has its share of competent staff, most are seconded from other government agencies and are frequently rotated out of the secretariat. This practice undermines organizational capacity and institutional memory. When required to second staff in preparation for upcoming elections, other local government agencies are reluctant to provide their most qualified or productive staff. One reason for this is that KPUD assignments are considered of low importance. Any position in the KPUD is outranked by the equivalent position in a line ministry. For example, the bureaucratic rank of the secretary of a district election commission is one rank lower

than the secretary of the health or education department. Partly because of this, and partly because of its isolation from the core activities of local administration, within Indonesia's civil service the KPUD is often seen as a career dead end. New recruits are often graduates with poor prospects for career advancement. Even though amendments to the electoral law gives the KPUD new human resource management powers, including the power to hire some staff, powers must be executed in convert with other national civil service regulations, which are cumbersome and ill-suited to developing the expertise required. For example, according to civil service rules, new entrants can only be promoted to the next level after eight years of service. Such human resource constraints have a negative impact on secretariat performance.

One way for Indonesia to strengthen its local election commissions could be to follow the example of the highly successful Corruption Eradication Commission (KPK), which struggled for two years to win the authority to recruit personnel outside of the Indonesian civil service. If similar authority was given to the KPU, it would increase its ability to recruit and retain more competent staff. Mexico's electoral management body recruits and manages its staff in this manner, providing a possible reference for Indonesia's policymakers.

Another unresolved human resource management problem confronting the KPUD is the relationship between the secretariat staff and the election commissioners. Because secretariat staff are civil servants, they are recruited, remunerated and promoted by the local government executive. While, in theory, the KPUD secretariat reports to the commissioners, the commissioners' authority is weak because most secretariat staff are on a short secondment and because commissioners have very limited hiring and firing power. The Law on Election Administration (Law No. 22/2007) granted commissioners authority to appoint some professional staff, but it did not grant them powers to control key staff appointments such as the head of the secretariat. Instead, the head of the secretariat, the most influential member of the KPUD, continues to be appointed by the local government executive. This practice undermines both the operational autonomy and effectiveness of the KPUD, and leaves it vulnerable to political interference.

The potential for political interference becomes even greater at the sub-district and polling station level where electoral officers are

appointed by local officials on an ad hoc basis during the first 30 days of the election preparation phase. During the preparation phase of local executive elections, district and municipality KPUDs appoint five electoral support staff (PPK) in each sub district. Their responsibilities are to assist KPUD, and to recount and tally election results from each of the sub district's polling stations. While the law is silent on the mechanism for appointing sub-district electoral officials, they are typically appointed by the sub-district head (*camat*). Polling staff at the village and polling station levels are appointed on the recommendation of the village/neighborhood heads (*kepala desa/lurah*) in accordance with the law. However, the formal eligibility requirements for polling station staff are so onerous and the remuneration so low that the job is generally not considered attractive. The criteria for appointment is essentially the same as for KPUD commissioners—appointees need to obtain (and pay for) medical certificates and a notice from the court testifying that they do not have a criminal record. Again, Mexico might provide a reference for Indonesia's policymakers here. In Mexico polling station officials are selected by a national lottery. In some European countries electoral officials are called up from among the public in the same way people are summonsed for jury duty.

Electoral officials at the Subdistrict Level

PPK	Panitia Pemilihan Kecamatan
PPS	Panitia Pemungutan Suara
KPPS	Kelompok Penyelenggara Pemungutan Suara

Election Financing and Budget Issues

While frequently overlooked by critics of election management in Indonesia, election finance mechanisms are a major constraint on efficient electoral administration. The chief source of finance for local executive elections is the local government budget. Government regulations require KPUD to submit its budget plan to the government executive in time for incorporation into the government's annual budget and work plan. This means that funds are only made available once the annual budget is approved. This causes major difficulties for the KPUD because the preparation and approval of the government's

budget rarely coincides with the election cycle. Much critical election work such as updating the voters' list takes place outside the official implementation period, but there is no separate budget for this work. A lack of readily available funds is a major underlying cause of many weaknesses in electoral administration, including voter registration and voter education/information campaigns.

Local governments also have a tendency to slash KPUD budget proposals leaving KPUD with inadequate funds. The government budget also excludes a number of direct costs such as overtime payments for KPUD staff. And while KPUD is held legally responsible for procurement of election materials and services, cost standards are typically set by the local government executive. Even though Law No 32/2004 authorises KPUD to set cost standards, local government control over the budget effectively limits KPUD's ability to set these standards. KPUD dependency on the local government executive for budget management creates the undesirable situation in which election officials are sometimes forced to curry favour with the local executive. Favouritism towards incumbents has been observed by researchers in a number of areas, most noticeably in the candidate verification process. One study noted that KPUD tended to be more lenient towards the incumbent than towards rival candidates.[18] This problem has only been partially addressed by amendments to the election law, which now requires incumbents to resign upon announcing their candidacy for re-election.

Despite this small step, unless local election commissions are empowered to manage a budget that is synchronised with the electoral cycle rather than with the government's financial year, it is difficult to see how the problem of financial pressure will be resolved. The timely allocation of funding is needed to reduce the risk of disruptions as well as the misallocation of resources. It is also needed to protect the neutrality and integrity of KPUD.

The mechanism by which local elections are financed also leads to dramatic variations between regions in the quality of local elections.

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[18] Report prepared by Banten District Election Oversight Committee, 2007, cited in Gumay and Stephen Sherlock, "Local Executive Elections: Policy Lessons for Electoral Administration and Democratic Governance".

Wealthier regions have greater resources to conduct local executive elections, while poorer regions have less. Under the current system, under-resourced regions are unable to access top-up funding from the center. Experience from other countries suggests that it is more effective if all elections are funded from a single budget source. In Indonesia, the central election commission could be made responsible for allocating budgets to the provinces and districts on the basis of formulas determined by election administrators. This would help to better integrate local executive elections into the elections regime and, at the same time, strengthen the central election commission's oversight of the process.

The Role of Local Government in Organizing Elections

While KPUD is the chief election management body responsible for local executive elections it is not the only one. Executive government also participates directly in the organization of elections via the Local Executive Elections "Desk". Under Ministry of Home Affairs regulations created prior to the first round of local executive elections in 2005, the Ministry of Home Affairs established a national Local Executive Elections Desk in Jakarta with representative branches in all provinces, districts and municipalities.[19] Local Executive Elections Desks are funded generously by the Ministry to provide a range of key electoral support activities including the provision of technical assistance to the KPUD, the conduct of voter education (*sosialisasi*), conflict monitoring and the supervision of all stages of the electoral process. While there is evidence that Local Executive Elections Desks have made positive contributions to the electoral process in some regions, there is also evidence to suggest that the Desks have been disruptive to the process in others.[20] Overall, however the existence of the Desks is a threat to the credibility of local executive elections. This is because many of the Desk's functions overlap with the responsibilities of the KPUD and the election oversight committee (Panwas). The Local Executive Elections Desk blurs the lines of institutional accountability. As an example, in

[19] Ministry of Home Affairs Regulation No 9/2005 Chapter IV on Regional Election Management.

[20] Rozi, Syafuan "*Netralitas Birokrasi dalam Pilkada Langsung di Indonesia 2005- studi kasus Malang, Gowa, dan Kutai Kartanegara* (Neutrality of the Bureaucracy in Indonesia's Local executive elections in 2005 - cases study from Malang", Gowa, and Kutai Kartanegara) Lembaga Ilmu Pengetahuan Indonesia (LIPI, 2006).

one district the Local Executive Elections Desk formally announced the results of the election before KPUD.[21]

Local Executive Elections Desks also provide a legal mechanism for the direct intervention of heads of local government in the elections.[22] Desk staff are recruited from the public service, the police and public prosecutor's office. The Desks are usually headed by the head of the local government executive's secretariat (Sekda) who reports directly to the head of government. In cases where the incumbent is running for a second term, evidence from the field suggests that the Desk has been used as an instrument for interfering in the electoral process. Reports indicate that Desk-sponsored voter education campaigns sometimes resemble political campaigns for incumbents[23], underlying the importance of transferring these functions to an independent election management body.

While the level of engagement of Local Executive Elections Desks varies between localities, in many places, the size of the Desk budget provides an indication of their significance for the elections. Generally, Local Executive Elections Desks have much larger budgets for voter education and election awareness campaigns than the local elections commission. This provides opportunities for political interference in the electoral process. An increasing body of evidence from the field to suggest that the operations of the Local Executive Elections directly desk undermines the autonomy of the KPUD, and is out of step with international best practice.[24]

Voter Registration: Overlapping Authorities and the Question of Accountability

Voter registration is one of the most important stages of the election cycle, but it remains one of the biggest weaknesses of election

[21] Gumay, Hadar and Stephen Sherlock, "Local Executive Elections: Policy Lessons for Electoral Administration and Democratic Governance".

[22] Zuhro, Siti "Posisi Birokrasi dalam Pilkada Langsung di Malang" (The Role of the Bureaucracy in Malang's Local Elections), *Jurnal Demokrasi & HAM* (Democracy and Human Rights Journal), Vol. 6 No. 2, 2006.

[23] Evans, Kevin, Bima Arya Sugiarto and Ahmad Kusworo, "Conducting Regional Elections in Indonesia: the Challenges of Reform", unpublished research paper, United Nations Development Program (Jakarta: Indonesia, 2009).

[24] Gumay, Hadar and Stephen Sherlock, "Local Executive Elections: Policy Lessons for Electoral Administration and Democratic Governance"; and Evans, Kevin, Bima Arya Sugiarto and Ahmad Kusworo, "Conducting Regional Elections in Indonesia: the Challenges of Reform".

management in Indonesia. Irregularities in the voters' list remain the primary source of election-related disputes. Arguably, the quality of the voters' list has been even poorer for local executive elections than for general elections. While there are a number of proximate causes for problems with voter registration, including the relatively short time allocated for updating the list, this study finds institutional accountability to lie at the heart of the problem.

Like its national counterpart, the local election commission does not have independent authority for compiling the voters' list. According to the law, voters' lists are prepared by the Ministry of Home Affairs on the basis of government population data. Prior to elections, the government submits the data to the local election commission for updating. The local election commission is responsible for updating the list and for giving eligible voters an opportunity to check that they have been properly included. Unfortunately, however, government data remains outdated and incomplete, and KPUD lack the time and resources needed to improve the data after they receive it.

As an example, an independent audit of the Jakarta voters' list in the lead up to elections for the Governor of Jakarta in 2007 found that only 77.8 per cent of eligible voters were registered. Furthermore, 20.8 per cent of registered voters were found to have been ineligible.[25] By contrast, in Aceh, where special circumstances led to the establishment of an Aceh Independent Election Commission (KIP), 86.9 per cent of eligible voters were found to be registered, despite widespread population displacement due to previous conflict and the 2004 Indian Ocean Tsunami. Because of the need to update population data in the wake of the tsunami, KIP had access to a new voters' list compiled by Indonesia's Bureau of Statistics (BPS) under the supervision of the central elections commission using the traditional door-to-door registration method.[26] When new laws required KIP to use government population data as the basis for the voters' list prepared for the April 2009 general elections, the quality of the voters' list declined.[27]

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[25] Source: LP3ES & NDI, Press Release: Most Eligible Voters in Jakarta Registered, 21 June 2007, http://www.jurdil.org

[26] Source: Jurdil Aceh, "Most Eligible Voters in Aceh Registered", 3 November 2006, http://www.jurdil.org

[27] Interview with election officials, Banda Aceh, 8 April 2009.

The Aceh experience, while born out of tragedy, highlights the benefits of making the elections commission responsible for the voters' list. It also highlights the advantages of allowing a longer lead time for conducting voter registration—up to 12 months can be needed to ensure the accuracy of the list. Because the official implementation schedule for local executive elections only provides 10 days for updating the voters' list, it is not surprising that it contains many errors.

Election Oversight and Dispute Resolution

Successful democratic elections depend not only on the effectiveness of implementing institutions, but also on the effectiveness of oversight and dispute resolution mechanisms. Ensuring effective election oversight and dispute resolution has been a challenge since Indonesia's return to democracy in 1999. In Indonesia, the Election Oversight Committee (Bawaslu) serves as the chief election oversight body. Bawaslu is now a permanent body at the national level. In the lead up to each election, Bawaslu establishes ad hoc committees (Panwaslu) at the provincial and district levels. Because the focus of this study is local executive elections, the analysis here will focus on the role of Panwaslu rather than the national-level Bawaslu.

The Regional Election Oversight Committee (Panwaslu)

Panwaslu committees are established 30 days prior to the commencement of local executive elections implementation, or 210 days prior to elections.[28] The committees are responsible for monitoring all stages of the election process and for passing on reports of violations to the appropriate authorities. While only the Constitutional Court has the power to adjudicate disputes over election results, Panwaslu is responsible for dispute resolution during all other stages of the local executive elections. This difference in function between elections has cause a great amount of confusion.[29] Each Panwaslu committee consists of three

[28] The Panwaslu committees established for Local executive elections are referred to in official documents as "Panwaslu Kada".

[29] Legal ambiguity continues to surround the dispute resolution functions of Panwaslu during Local executive elections. This is because while Law No 22/2007 was meant to clarify the authorities of all election management bodies including Panwaslu (i.e. superseding Law No 32/2004 on Regional Autonomy), the law failed to specify dispute resolution functions that were outlined in 32/2004. In the lead up to the current round of Local executive elections, Bawaslu asked for legal advice on the matter. A first group of legal advisors argued that because it was

members. The national oversight committee is responsible for appointing the members, but the nominations are provided by the local election commission. Administrative support staff are seconded from government agencies for the duration of the election organizing period.

Panwaslu Responsibilities

Panwaslu responsibilities are specified in Law No 22/2007 on Election Administration. According to the law, the duties of the district and municipality election oversight committee are:[30]

(a) Supervising all stages of election implementation including (i) updating voter data based on population data and affirmation of preliminary voters' register and final voters' register; (ii) candidate nomination; (iii) candidate verification; (iv) campaign implementation; (v) election supplies procurement and distribution; (vi) voting; (vii) supervision on the whole process of vote counting; (viii) movements of ballot papers from the polling stations to PPK; (ix) vote recapitulation; (x) recounts, re-voting, second, and make up elections as required; and (xi) affirmation of election results;

(b) Receiving reports on violations of election laws or regulations;

(c) Managing findings and reports concerning disputes on non criminal election matters;

(d) Submitting findings and reports to KPUD for follow up;

(e) Conveying findings and reports beyond the Panwaslu mandate to relevant authorities;

(f) Submitting reports to Bawaslu regarding any compromise of the election process by election implementers;

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not outlined in 22/2007, Panwaslu no longer had dispute resolution functions in Local executive elections. However, a second group of experts argued that provisions in 32/2004 would still apply if it did not contradict 22/2007. Bawsalu adopted the second group's view, which has upheld Panwaslu's dispute resolution role in Local executive elections, but this authority remains open to challenge because of the ambiguity in the law. E.g. a party to dispute resolution might have a legal basis for refusing to acknowledge Panwaslu's authority to adjudicate. The upcoming Local executive elections law presents an opportunity to clarify Panwaslu's dispute resolution function.

[30] The law also specifies the responsibilities of election oversight committee at the provincial and national level. Nearly all duties are the same for Panwaslu at the district and municipal levels, Panwaslu at the provincial level and Bawaslu at the national level. However, only district and municipal Panwaslu are responsible for supervising the movement of ballot papers from polling stations to election officials at the sub-district level (PPK).

(g) Supervising the imposition of sanctions on staff found to have acted improperly;

(h) Supervising voter education activities

Panwaslu Role in Dealing with Administrative and Criminal Violations

While Panwaslu is required by law to oversee all stages of the election process, its main function is to receive and forward reports of electoral violations. There are two main types of violations that Panwaslu deals with—criminal and administrative. Examples of criminal violations include vote-buying, campaigning outside official campaign periods, and use of public resources in campaigns. Other crimes such as vandalism, arson, physical assaults, and assassination are considered to be crimes of a general (i.e. not election-specific) nature and fall under the general criminal code. Examples of administrative violations include, inter alia, inconsistencies in the vetting of candidates' against eligibility criteria and the updating of voters' lists, and procedural errors in vote counting and recapitulation. Upon receiving a report of a violation, Panwaslu's role is to first determine whether the report has merit. If it is found to have merit, Panwaslu forwards a report to the police (for criminal violations) or to KPUD (for administrative violations). It is then the responsibility of the police or KPUD to respond to complaints.

In other elections in Indonesia (parliamentary and presidential) administrative and criminal violations must be dealt with within a legally specified time frame in order to minimise political uncertainty. For criminal violations police have 14 days to gather evidence. The public prosecutor then has only five more days to submit the case to the district court. For administrative violations, KPUD has only seven days to respond following receipt of Panwaslu's report. While time limits sometimes mean that there is insufficient time to gather evidence, time limits are nevertheless necessary to ensure that cases with possible implications for the election result are handled quickly. Unfortunately, however, the law does not specify time limits for handling local executive elections-related violations.

Furthermore, (and this applies to all elections in Indonesia) Panwaslu does not have the authority to ensure that either the police or

KPUD follow up on reported criminal or administrative violations. Neither does the complainant have recourse to the courts if the local election commission fails to act—a major lack of procedural safeguards. And where complaints or administrative violations involve improper conduct on the part of local election commission staff, the local election commission is usually disinclined to follow up. These problems will continue to plague elections unless Panwaslu is strengthened as an institution, i.e. until the body is transformed into an elections complaint commission with enforcement powers.

Panwaslu Role in Dispute Resolution

Controversially, Panwaslu has been made responsible for the resolution of disputes emerging during any stage of local executive elections—a responsibility that it does not have in other elections. Election-related disputes are those which occur during implementation and are to be distinguished from disputes over election results, which can only be adjudicated by the Constitutional Court. Election-related disputes typically arise from conflicting interpretations of electoral laws and regulations. For example, the most common type of dispute to come before Panwaslu is one in which candidates have conflicting views over the delimitations of a campaign zone, i.e. two candidates both claim a particular site. If one candidate is clearly campaigning outside the boundaries of his/her zone then this constitutes an administrative violation to be referred to the local election commission. But if the campaign boundaries have been unclearly specified by the local election commission, then this becomes a dispute that Panwaslu has the power to adjudicate.

Bawaslu has issued regulations outlining Panwaslu's role in dispute resolution during the conduct of local executive elections.[31] According to Bawaslu regulations, sub national Panwaslu committees are to observe the following steps in resolving disputes:

(i) Receive report from complainant
(ii) Seek clarification
(iii) Examine report to assess whether complaint relates to (a) criminal violation, (b) administrative violation, or (c) dispute

[31] See Bawsalu Regulation No. 24/2009.

(iv) Negotiate an acceptable agreement between parties to the dispute
(v) If no agreement, make final and binding decision
(vi) Publish the written agreement or decision (*berita acara*)

While the new regulations are clear, their implementation has proved to be a challenge. This is because Panwaslu committees do not have the expertise needed to properly adjudicate election-related disputes. Another concern is that while Panwaslu decisions are final and binding on the parties to the dispute, Panwaslu has no power of enforcement. If parties to a dispute choose to ignore Panwaslu's decision, there is nothing that Panwaslu can do about it. In the most recent rounds of direct executive elections, only a handful of the estimated 1636 rulings by Panwaslu committees have been followed up by the Local Elections Commissions or local law enforcement agencies.[32] The law does not specify a mechanism for dealing with such situations. Panwaslu clearly cannot be effective in resolving disputes unless it has the power to ensure compliance with its decisions.

Panwaslu Organizational Capacity

Like the local elections commission, Panwaslu effectiveness is hampered by the difficulty of recruiting suitably qualified personnel. The ad hoc nature of the commission, its lack of resources and the rigidity of eligibility criteria are serious obstacles for recruitment. Panwaslu commissioners are required to work full-time from one month before the election period until one month after the election period—a total period of 240 days. Many of the most qualified candidates for the positions tend to be already occupied with full-time work. The low pay and low status of the positions are poor incentives. Positions at Panwaslu are ranked below equivalent positions at KPUD. It will be difficult to attract capable and qualified candidates, unless the remuneration and status of the positions are increased.

The Election Law requires KPUD to initiate the formation of Panwaslu 30 days before the start of the election implementation period

[32] Interview with Election Oversight Committee Member, Wahida Suiab, Jakarta, 9 November 2010.

and to dissolve it 30 days after the elections. Candidates must obtain health certificates and police checks, which takes time. Often, prospective commissioners have to bear these costs themselves. While the background checks are important, the administrative process tends to discourage prospective candidates. And recruitment is almost never finalized in time, leaving many stages of the election without adequate oversight. In many cases the recruitment of Panwaslu members only begins at the 30-day mark, instead of prior to the 30-day mark—a problem which stems from the ambiguity of electoral rules. Regulations need to make it clear that Panwaslu must be operational by the 30-day mark at the latest.

New electoral laws separating Panwaslu from the police and public prosecutor's office may serve to boost Panwaslu's neutrality, but they also reduce Panwaslu's ability to harness those agencies' investigative skills and legal expertise. Such capacity is now supposed to be developed within Panwaslu itself, but with the current level of resources, it is difficult to see how such capacity can be built at sub national levels. Resources are limited and Bawaslu is not inclined to spend money on training because of the impermanent nature of Panwaslu and high staff turnover. Even when it is able to allocate funding, funding is often not available in time. As a lower-level agency (i.e. its chief is not a top echelon civil servant), Bawaslu does not have the authority to manage its own budget. All expenditure is processed through the Ministry of Finance.

New electoral laws also reduce Panwaslu capacity by downsizing the body's key staff. The 2007 Law on Election Administration reduced the number of commissioners at the provincial, district and sub-district levels from five to three. Panwaslu commissioners are supported by a handful of secretariat staff seconded from other government departments. As is the case with secondments to the KPUD secretariat, local governments are generally not inclined to share their most competent officers with Panwaslu and expertise in election oversight is often lacking.

A lack of budget control and poor timing of finance undermine the operational effectiveness of Panwaslu. In Bengkulu Province, for example, Provincial Panwaslu recently submitted a proposed budget of 25 billion rupiah (US$2.77 million) for oversight of elections in 11

districts and municipalities. However, the provincial government authorized funding of only two billion rupiah (US$222,000), which is approximately US$20,000 per district for eight months of election oversight and dispute resolution activities. In another district in Central Java, only Rp 250 million was provided for Panwaslu activities in 278 villages, amounting to a little over $US100 per village for eight months work. In other places Panwaslu is still waiting for the funding it has been promised.[33]

Given capacity challenges, higher level supervision of Panwaslu activities will be essential. However, during elections for heads of district and municipal governments, Panwaslu is not established at the provincial level. District and municipal Panwaslu committees come under the direct supervision of Bawaslu in Jakarta. Given the central body's lack of resources, it is unable to provide much support. Bawaslu does not even have enough funds to conduct eligibility ("fit and proper") tests of newly nominated Panwaslu members even though it is required to do so by law.[34] If Bawaslu/Panwaslu is to be retained as a meaningful election oversight and dispute resolution body, it needs to be given resources commensurate with its duties. Currently, neither Bawaslu at the national level nor Panwaslu at the sub-national level has the resources needed to properly discharge its election oversight and dispute resolution duties.

Conclusion

Indonesia has been hailed as a democratic success story since returning to multiparty democracy in 1999. Direct elections have now been held on a regular basis for president, heads of local government and national and sub-national legislatures. In recent years, however, the quality of electoral governance has gone backwards. Because democracy cannot survive without credible institutions to implement elections and settle election-related disputes, strengthening electoral governance will be essential for democratic consolidation in Indonesia over the coming decade.

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[33] Interview with Election Oversight Committee Members, 15 January and 9 November 2010.
[34] Interview with Election Oversight Committee Member, Wahida Suiab, Jakarta, 9 November 2010.

While public and scholarly criticism of electoral governance in Indonesia has generally targeted the competencies of election administrators, findings from this study suggest that the most pressing problems with electoral governance in Indonesia are structural and can only be addressed by institutional reform. The Indonesian case demonstrates that it is difficult to improve the quality of electoral governance if election management bodies remain too heavily dependent on executive government processes and resources. Findings from this study suggest that Indonesian policymakers should reconsider the powers and responsibilities of election management bodies and the institutional relationships between them. Overlapping functions between various government agencies responsible for organizing elections has created an accountability crisis. Similarly, overlapping authorities between the Ministry of Home Affairs and the Election Commission obfuscate accountability for voter registration, which remains the single major source of election-related disputes. Both agencies regularly blame each other for weaknesses in voter registration. Local election commissions are also totally reliant on local government budgets, making local electoral commissions susceptible to political pressure. It also leads to wide regional variation in the quality of local executive elections. As it stands, the central government does not intervene to ensure that local election commissions throughout the archipelago have sufficient resources to fulfil their mandates. Institutional reform of Indonesia's electoral governance framework is urgently required. This is as much a political problem as it is a technical problem for Indonesia's reformers. Part of the challenge lies in convincing Indonesia's powerful Ministry of Home Affairs—the agency that controlled local governments throughout the authoritarian period and that continues to oversee regional autonomy today—that it should relinquish some of its authority for organizing elections. This will be difficult because the budget attached to such responsibilities is large. Similarly, to make Panwaslu a credible and effective election oversight and dispute resolution body, it needs to be given powers and resources commensurate with its tasks.

REVIEW OF POLITICAL DEVELOPMENT

Corruption, Security, and Political Competition

Department of Politics and IR

The Democratic Party's shape of disarray is indeed continuing during the month of June 2011. Its former treasurer, Nazaruddin is allegedly involved in a bribery scandal of the Southeast Asian Games athletes' dormitory construction project and reportedly attempting to give gratuities in 2010 to the Constitutional Court secretary-general Djanedri M. Gaffar. The decline continues as there was no resolute response from the Party's executive board as well as its chief patron, Susilo Bambang Yudhoyono. The fact that the party does not discharge Nazaruddin as its representative in the parliament and not being stringent could be interpreted by the public as giving an evidence that the democratic party is being very permissive to corruption. Clearly that any decision carried out by the democratic party or lack of it would generate public's opinions.

The party also lost some credibility just after Nazaruddin, via his lawyer – O.C. Kaligis, threatened to reveal more corruption scandals within the party. Just almost at a similar time, other scandal which closely linked a member of the Democratic Party was emerged. One of relatively new members of the party, Andi Nurpati, who was a former member of the National Election Committee (Komisi Pemilihan Umum – KPU), allegedly named in 2009 election forgery case. Andi Nurpati, Mashuri Hasan (a former Constitutional Court staffer) and Zainal Arifin Hoesin (a former Constitutional Court clerk) are allegedly forged an official letter that enabled Dewi Yasin Limpo of the People's Con-

science Party (Hanura) to win a House seat in the 2009 election. The court officially ruled that the seat should be given to Mestariani Habie from the Greater Indonesia Movement Party (Gerindra). The internal investigation which was conducted after Mestariani filed her case also revealed the possibility involvement of former Constitutional Court's judge, Arsyad Sanusi. The party is obviously loosing some credential, credibility and attractiveness, hence, the party greatly requires a comprehensive strategy to regain the trust of the public and rejuvenate the party's positive image in order to revamp itself to stay on top for the next election.

As promised by Nazaruddin's lawyer, Nazaruddin made a public appearance through a live interview which was broadcasted by two national television channels. On his first interview after he was declared as a fugitive, Nazaruddin confirmed that he is currently overseas and he reiterated his accusations against party members in corruption cases. Nazaruddin revealed fellow party members' involvement of corruption in various government-funded projects, including Hambalang construction project (a stadium in Bogor) in 2010 and an athletes' village built in Palembang, South Sumatra, for the 2011 SEA Games. He also accused that the Corruption Eradication Commission (KPK), which is investigating a bribery case related to the 2011 SEA Games, had conspired with party chairman Anas Urbaningrum to trap him. Additionally, Nazaruddin claimed that the KPK also held evidences of Anas' wrongdoings but had decided not to pursue him after receiving gratuities.

The turmoil within the Democratic party which was caused by Nazaruddin's accusations has resulted in mounting calls for the party's serious response both towards Nazaruddin, the whistle-blower, and towards the allegations to avoid further indictment against the party. Many believe that the party's weak leaderships and ineffective management contribute substantially to the disarray. The party decided to hold a national coordinating meeting in the last week of July 2011. Most pundits and observers were very certain that this national meeting would be chaotic, however, it ended without no stringent action nor decision about the party leadership-restructuring proposal. It is obvious that the chief-patron of the party is still a determining factor, hence, the party members also most of Indonesians were disappointed

by the SBY's sluggishness. Instead of giving a firm and authoritative action, SBY only encouraged the Democratic Party members not to be disheartened by this turmoil and asked them not to blame each other. This is clearly not a good example for modern political party management and also might serve as a negative evidence for corruption eradication efforts in Indonesia.

Nazaruddin also accused several names who are high-level officials of the Corruption Eradication Commission (KPK) being involved in the ongoing corruption investigation processes. Nazaruddin cited that deputy chairman Chandra M. Hamzah, enforcement deputy Insp. Gen. Ade Rahardja, spokesman Johan Budi, investigator Adj. Sr. Comr. Roni Samtana and Mochammad Jasin met him to discuss and receive bribes to intervene in corruption investigation processes of some cases. This accusation is very timely with the initial process of selecting new post as KPK's leaders.

The result of first stage screening (written test) of nominees on the selection process the Corruption Eradication Commission (KPK) leaders is 17 candidates out of 127 passed through to the next stage. Some candidates who have succeeded to the second round are including the Financial Transaction Reports and Analysis Centre (PPATK) chairman Yunus Husein, Indonesian Corruption Watch (ICW) honorary council member Bambang Widjojanto, National Police Commission member Adnan Pandu Pradja also KPK advisor Abdullah Hehamahua and Handoyo Sudradjat. High-profile candidates with experiences in leading the anticorruption agency failed the test, including KPK deputy chairman Chandra Hamzah, KPK deputy for enforcement Ade Rahardja and KPK spokesman Johan Budi. Many believe that the failure of the three was linked to a series of Nazaruddin's allegations made against them, though the link was denied by the selection committee. The selection committee claimed that the allegation did not influence the selection process and they are looking for more innovative approaches in corruption eradication effort, where the three candidates failed.

It is highly imperative for the anti-corruption agency to regain the public trust. Thus, the fact that the selection committee did not authorize the controversial names into the second round might give a clear signal that Indonesia requires a credible agency in its effort to seriously

eradicate corruptions. However, the final decision will be on the hand of the parliamentary members. Doubts remain ubiquitous whether the parliament will choose the most credible persons to lead KPK or will it be business as usual for Indonesians' representatives in the parliament.

A good news emerged on the first week of August 2011, after Interpol announced that a man identical to Indonesian fugitive corruption suspect, Muhammad Nazaruddin in Cartagena, Columbia. The man was arrested on his attempt to leave Colombia on a passport under the name of M. Syahruddin. Shortly after the Interpol's announcement, the Coordinating Minister for Politics, Law and Security Djoko Suyanto claimed the arrest as a result of a good cooperation between Interpol, Columbian Police, Indonesian National Police, the Corruption Eradication Commission (KPK), immigration bureau, the Law and Human Rights Ministry and also the Foreign Ministry. He added that the government already set up a special team consisting of ministry and law enforcement officials, including the police, Corruption Eradication Commission (KPK) investigators and immigration officers, to verify whether the arrested man was indeed Nazaruddin, hence, the team were already on their way to Bogota. He also ensured that the look alike will be given the utmost protection and will be brought back to Indonesia safely. Djoko Suyanto confirmed that Nazaruddin will be handed directly to the Corruption Eradication Commission (KPK) upon his arrival in Indonesia as a symbol that the government will abide the law and ensure the legal process of Nazaruddin's case will be carried out by the KPK.

During a press conference on the sidelines of Nazaruddin's interrogation, Corruption Eradication Commission (KPK) chief Busyro Muqoddas said Nazaruddin is allegedly involved in 31 different graft cases which implicated about Rp 6.04 trillion (US$706.68 million) in total funds. Busyro also added that Nazaruddin was expected to reveal the "mafia practices" within the parliament's budget committee. Anticorruption activists and analysts have repeatedly alerted the public that "almost zero" oversight on the House's budget committee has allowed political parties to feed illegally from the state budget to finance their day-to-day operations and accumulate capital for the 2014 general election. Nazaruddin is now officially a KPK detainee and is being

held at the police's Kelapa Dua detention centre in Depok, West Java and Indonesians were very eager to witness a new dawn in corruption eradication efforts.

However, the hope seems to diminish shortly after Muhammad Nazaruddin wrote a letter to President Susilo Bambang Yudhoyono, who is also the Democratic Party's chief patron, calling for his wife and three children to be protected only after six days being held in the detention centre. The copy of his letter which has been published in the newspaper, reads as follows:

> *Jakarta, August 18, 2011*
>
> *To: The President of the Republic of Indonesia Susilo Bambang Yudhoyono In Jakarta*
>
> *I beg you to immediately send me to jail without the need for a judicial process. I am willing to be put in prison for years as long as you promise to give material and mental peace to my family, particularly my wife and children.*
> *I have to explain that my wife is indeed a domestic woman who knows nothing about the affairs of the party. I also promise that I will not disclose anything that could damage the image of the Democratic Party or the KPK, for the sake of the nation.*
> *Here is my letter in which I kindly ask for the help and attention of Mr. President.*
>
> *Kind regards,*
> *Muhammad Nazaruddin*

The President did not swiftly response to this plea, but the Presidential Spokeperson, Julian Pasha insisted that the President would not intervene in the legal proceedings against Nazaruddin. The Secretary Sudi Silalahi even stated that The President will not reply this letter. Along with the letter, Nazaruddin told the press that he had forgotten everything he said during TV interviews that he conducted while on the run abroad. In those interviews he accused several politicians, including party chairman Anas Urbaningrum, of corruption and vote

buying. This "sudden silent" act surely hamper the progress of current legal proceedings on corruption eradication efforts and certainly brought down the public hopes. Beyond expectation, the President replied Nazaruddin's letter, reads as follows:

Jakarta, August 21, 2011

To: Muhammad Nazaruddin
On Sunday, August 21, I read your letter, although I had heard about it from mass media reports. To make it clear to the Indonesian people, I decided to answer through this letter.
Regarding the legal process you are currently facing, let us follow the law in this country. In any legal case, implicating anyone, I have never and would never intervene in the legal process, which should be independent and free from any intervention.

The principle of non-interference and a free and fair legal process are stated and guaranteed by the 1945 Constitution, relevant laws and other regulations.

Therefore, I suggest that you be cooperative in dealing with the ongoing legal processes. I am convinced that the Corruption Eradication Commission (KPK), which is handling your case, will work professionally, independently and fairly.

Tell the KPK everything you know that may be valuable before the law and make it clear and complete. This includes information about anyone responsible [in your case], regardless of the institutions or the parties. Why? The law must be upheld based on evidence without prejudice. Under the principle we pursue equality before the law, which is guaranteed by the 1945 Constitution.

Regarding the safety of your family, in every case, not only your case, I always instruct legal officers to work professionally to ensure the safety of relevant parties. It is the responsibility of the state apparatus to guarantee the safety of all citizens.

> *This does not mean, however, exemption from the legal process that exists when citizens are implicated in a legal case. We must ensure that law enforcement will be fair, transparent and accountable and devoid of bargaining or negotiation in any forms.*
> *I hope that you can think introspectively during this Ramadhan. Happy fasting. May God bless us all.*

Nazaruddin then, through his lawyer, sent a letter to KPK chairman Busyro Muqoddas, renewing calls for a detention transfer, which has been informally rejected by the KPK on security grounds. Nazaruddin's lawyer Afrian Bondjol said Nazaruddin suspected the rejection of a detention transfer was due to KPK leaders' fear that he would disseminate undesirable information about them. Nazaruddin then stated that he refuses to cooperate with the KPK until the commission granted his transfer request to Cipinang Penitentiary. Unfortunately, this drama of Nazaruddin's corruption investigation is still ongoing. Many still put their hopes up high for Indonesia's corruption eradication efforts, others believe that this current investigation will not bring Indonesia to a corruption free environment. Hence, it is crucial for the anti-corruption agency to regain the public trust. The current selection process to choose KPK's leaders should be reliable. Additionally, a transparent, independent, and thorough investigation of Nazaruddin's case would give a clear signal that Indonesia is in its effort to seriously eradicate corruptions.

New Army chief: Strategic option for SBY's political manoeuvre?

President Susilo Bambang Yudhoyono installed his brother-in-law Lt. Gen Pramono Edhie Wibowo as Army Chief of Staff. Despite the fact that Lt. Gen Pramono Edhie WIbowo is the strongest Army chief hopeful amongst three candidates, many observers believe that there is a strategic plot to support SBY's future political plan. Lt. Gen Pramono is installed to replace Gen. George Toisutta who was retired by the end of June 2011. Prior to this post, Lt. Gen. Pramono was Army Strategic Reserve Command (Kostrad) chief and was previously an aide to former president Megawati Soekarnoputri. Pramono certainly met the basic qualifications for the post, he has vast experience as territorial commander and stints at the Army's Special Forces (Kopassus) and Kostrad, which traditionally serve as paths for Army chief hopefuls.

TNI's Council for High-Ranking Promotions and Duty Rotation (Wanjakti) thoroughly evaluated three candidates for the new chief of army. The other two candidates are Lt. Gen. Budiman, Army Deputy Chief of Staff and Lt. Gen. Marciano Norman, Army Educational and Training Command chief. Lt.Gen. Pramono Edhie Wibowo pledged to focus on developing the Indonesian Army. He also added that he would exhaustively develop the concept of professional army under his command.

Speculations emerged soon after Lt.Gen. Pramono was installed by his brother in-law, Susilo Bambang Yudhoyono. First, there is a high possibility that SBY will promote Pramono as presidential candidate in 2014 with the support of PDI-Perjuangan, since Pramono was Megawati's aide during her tenure. Second, there are speculations that President Susilo Bambang Yudhoyono's decision to install his brother-in-law Lt. Gen. Pramono Edhie Wibowo as the new Army chief of staff is indeed a political manoeuvre to restore his waning power. It is quite clear that the President's popularity as well as his Democratic Party is declining, hence, there is a high possibility that Lt. Gen. Pramono's territorial command structure would be use as an instrument to bring it back in order to compete in the 2014 election.

Obviously, professionalism should not intertwine with personal nepotism principle. It is imperative for Lt. Gen. Pramono to provide evidences to the public that he is the best army's soldier to lead the Army. However, it is also clear that it seems to be a zero sum condition. If Lt. Gen. Pramono succeeded in performing his duty as the Chief of Army, surely he will bring along all kinds of achievements including those which have been politically plotted.

Papua: Crying out for a liable solution

All Indonesians is supposed to share the glorious 66th independence, however, some believed that the dreams of the nation's founding fathers have not been achieved. One of the most striking indicators is the government mismanagement in Papua. Papua, until this current time, is still experiencing a prolong security threats and occurrence of violence, against the people, against the government officials and also against the security and law enforcers. Additionally, many believe that Papua is still on massive exploitations, since it is the most underdeve-

loped province in spite of its rich natural resources. The paradox has been exacerbated by rampant corruptions, violent rivalry over power on local elections, marginalization of local people as a side effect of migration and others continuing violence against Papuans, which sadly has not been addressed properly.

A number of bloody incidents occurred in the province. Amid the festive commemoration of Independence Day across Indonesia, suspected members of the Free Papua Organization (OPM) separatist group carried out attacks in the Papua regency of Paniai to follow a fatal ambush of a car in Nafri village, Jayapura, on early August 2011 which killed three civilians and a soldier. Clashes between supporters of two rival candidates for regent in the newly created Puncak regency claimed at least 19 lives. Additionally an outlawed Morning Star flag hoisted in Tanah Hitam in Abepura district of Jayapura on the 17th August 2011. Undoubtedly, the government needs to seriously address the violent threats in Papua and ensure the security of the province. Along with that, the government also has to comprehensively address the socio-economic injustice. Many believe that the most crucial initiative which has to be carried out by the government is to clearly decide the legal status of Papua, provide it with clear and resolute legal bases which correspond appropriately with the local wisdom and principles of "special autonomy".

Papua desperately needs a constructive engagement of the central government and not only symbolism which has been depicted as the palace distributed Papua-themed souvenirs to guests and six traditional songs were presented by a choir, which included a number of Papuans, greeted guests as they arrived at the palace on the official commemoration of 66th Independence Day in the Presidential Palace. Despite President Susilo Bambang Yudhoyono's pledge in his annual State of the Nation Speech to allocate an extra Rp 1 trillion (US$117 million) for infrastructure development in Papua next year, it is also significant if he officially appoints a special envoy. A special envoy will be representing the central government for the whole territory of Papua and communicating as official positions and messages from Jakarta and should be based on a Presidential decree to give the appointee a strong legal foundation. Furthermore, many believe that this envoy would clearly give a signal to Papuans that the central government

does not abandoned them and seriously looking for a liable, accountable and proper management of the province. It is important for Indonesia to keep the dream of the nation's founding fathers of the united Republic of Indonesia in this momentous 66th Independence.

Jakarta's governor election: Clash of the titans?

The Jakarta regional election committee (KPUD) has decided that the Jakarta gubernatorial elections would be more likely to fall on the 8 August 2012. Under the Law No. 32/2004 on Regional Administration, an election must be held no later than one month before the end of an incumbent's term. The first term of Jakarta current Governor Fauzi Bowo will end on 7 October 2012, hence, an election is due before 7 September 2012. Although Jakarta 2012 gubernatorial election may still be a year away but political parties and prominent figures have started to make their intention to nominate their candidacy bold to the public. Some tried to test the water for their popularity amongst the people of Jakarta, others are garnering support from political parties.

Several names emerged during July 2011 and most likely would run in the 2012 gubernatorial election. The incumbent, Fauzi Bowo is most likely be a candidate to run for his second term. The chairman of the Jakarta branch of the Democratic Party, Nachrowi Ramli; chairman of the Jakarta branch of the Golkar Party, Priya Ramadhani; and the chairman of the Jakarta branch of the Prosperous Justice Party (PKS), Triwisaksana also emerged as possible challengers for the bid. Other names such as former sport and youth affairs minister, Adhyaksa Dault, Golkar Party's legislature, Tantowi Yahya, former Marine General Nono Sampono and an economist Faisal Basri also expressed their willingness to run for the Jakarta gubernatorial election next year.

Jakarta's governor is indeed a prestigious post and also strategic in the context of winning the 2014 general election. Hence, a year early start is indeed crucial to prepare the candidates for the bid. It is essential to build a proper image to the voters but first and foremost the candidates need to prepare an innovative vision to properly govern the capital otherwise Jakarta will soon lapse.

REVIEW OF ECONOMIC DEVELOPMENT

ROBUST GROWTH, RISING RISKS

Deni Friawan

Overview

During the first eight months of 2011, Indonesia continued to show robust growth, yet risks are rising recently. The annual GDP growths remain strong, growing at 6.47 percent in Q1-2011 and 6.49 percent in Q2-2011. Inflation was also still under control and continued to ease, as the food prices slid and the government policy on fuel prices unchanged. Indonesia's headline inflation continued to decline to 4.79 percent in August 2011 from its early peak of 7.02 percent in January 2011. Policy interest rate, BI rate, was also stable at 6.75 percent for the last seven consecutive months, since the 25 basis point rise in February. Moreover, the international reserves were buoyant, increasing from US$95.3 billion in January to US$124.6 billion in August.

Nevertheless, downward risks on Indonesia economic outlook are rising. Although Indonesia maintains its positive trade balance during the first seven months of 2011, the nominal trade surplus narrowed recently as the average monthly imports growth from December 2010 to July 2011 outpaced that of exports due to the decline in global commodity prices. During the period of December 2010- July 2011, the average nominal monthly export grew by 2.8 percent, lower than that

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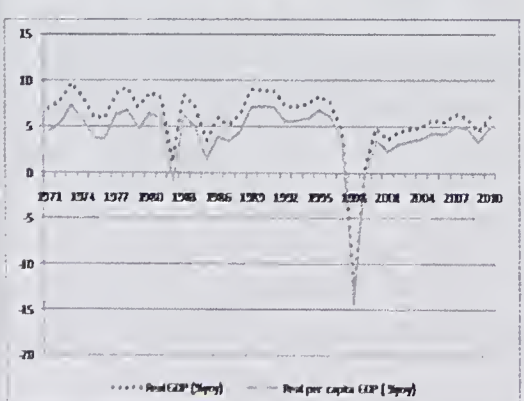
of import that expanded by 3.2 percent. As a consequence, Indonesia trade surplus continued to decline from US$ 3.7 billion in December 2010 to US$ 1.4 billion in July 2011.

Moreover, negative external sentiment, involving the downgrading of ratings for some countries, fear over the spillover in debt crisis to Italy and uncertainty over the debt limit in the US, increased downward pressure on rupiah and Indonesian stock market. After reaching its new all-time record of nearly 4,200 in early August, the IDX dropped to 3,369 in September 22, 2011, down by nearly 25 percent from its highest level in a year or 10.6 percent from its initial level in the beginning of 2011. Similarly, rupiah slightly depreciated by 0.1 percent from its initial level at Rp 8,976/US$ in the beginning of the year, despite its initial 6 percent appreciation.

Economic Growth

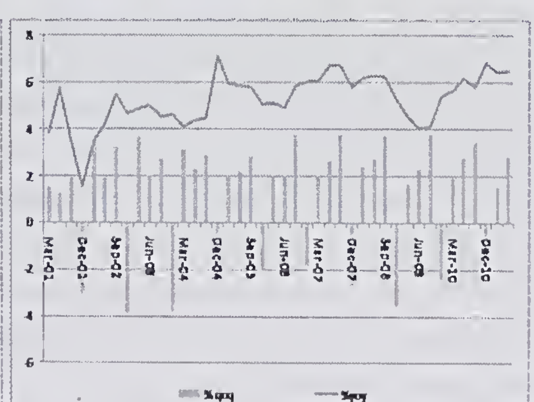
Until the first half of 2011, Indonesia's economy remained steady, amid rising uncertainty in global economy. The quarterly output continued to increase from 1.5 percent in Q1-2011 to 2.9 percent in Q2-2011, following a negative growth of 1.4 % in Q4-2010 (Figure 1b). After a significant increase of 6.86 percent in Q4-2010, however, the annual economic growth moderated to 6.47 percent in Q1-2011 and 6.49 in Q2-2011 (Figure 1a). This annual economic growth rate was higher than the government growth target of 6.3 percent and above its 10-years of 5.22 percent (Figure 1b).

Figure 1a: Long run growth



Source: World Development Indicator

Figure 1b: Annual and Quarterly GDP



Source: CEIC Database

Looking ahead, Indonesia growth outlook is expected to remain robust. Given the strong economic growth of the first half and the continued upward economic activity, the annual economic growth rate is expected to grow at 6.5 percent in 2011 and 6.7 percent in 2012. Yet, the recent increase in global uncertainty leaves a downside risk to this forecast. The IMF predicted that the Indonesia economic growth in 2011 would be lower than previously expected, growing at 6.3 percent.

Expenditure Side

On the demand side, the robust growth in the first half of 2011 was underpinned by the strong private consumption, buoyant investment and sound recovery in export demand, offsetting the slower growth in government spending (Table 2a). Driven by improvement in consumer optimism and consumer purchasing power, the private consumption grew by 6.5 percent in the first half of 2011 and contributed to nearly 40 percent of total GDP growth.

Table 2a: Expenditures growth and their contribution to total GDP growth

	Growth (yoy)						Contribution to growth					
	2010				2011		2010				2011	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
Private Consumption	3.92	4.98	5.16	4.44	4.48	4.57	2.29	2.85	2.89	2.57	2.57	2.58
Govt. Consumption	-7.96	-7.84	4.34	8.28	2.76	4.54	-0.58	-0.69	0.37	0.95	0.17	0.35
Gross Fixed Capital Formation	7.98	8.05	9.27	8.60	7.32	9.20	1.83	1.84	2.17	2.10	1.72	2.14
Stocks & Stat. Discrep.	55.83	135.72	13.21	6.93	75.56	-21.73	0.94	2.01	0.26	-0.37	1.88	-0.71
Net Exports	12.07	2.05	1.39	14.00	1.25	22.87	1.18	0.20	0.14	1.61	0.13	2.13
Real GDP Growth	5.66	6.21	5.83	6.86	6.47	6.49	5.66	6.21	5.83	6.86	6.47	6.49

Source: CEIC Database

Investment charted growth at 7.3 percent in Q1-2011 and 9.2 percent in Q2-2011, supporting by robust investment in construction sector, especially the property sector, as well as investment in machinery and transportation. In the first six months of 2011, investment contribution to GDP growth increased from 26.5 percent in Q1-2011 to 33 percent in Q2-2011. Investment healthy rise was underpinned by improvement in the domestic and global investment climate, an appreciation in rupiah, and growth of credit.

After a significant growth in first quarter of 2011, net export bounced back in the second quarter of 2011, driven by steady growth

in external demand, especially from emerging market economy such as China and India. After declining from 14 percent in Q4-2010 to 1.3 percent in Q1-2011, real net-export growth rate jumped to 22.9 percent in Q2-2011 (Figure 5a). Net export's contribution to total GDP growth was also increased from 2 percent in Q1-2011 to 32.8 percent in Q2-2011, higher than an average net export's contribution of 12.4 percent in 2010 (Table 2a).

Meanwhile, the growth in government spending slowed in the first half 2011 due to lagged disbursement in capital spending. The growth of government spending was 2.8 percent in Q1-2011 and 4.5 percent in Q2-2011, down from 8.3 percent in Q4-2010.

Production Side

While Agriculture growth was relatively stagnant, as seen in Table 2b, services continued to be the main drivers of growth on the production side, reflecting the strength of domestic consumption. Agriculture grew by 3.4 percent in Q1-2011 and 3.7 percent in Q2-2011, slightly increased from 3.3 percent in Q4-2010. This sector contributed only lest than 0.5 percentage point on average to growth in the first half of 2011.

Table 2b: Sectoral growth and their contribution to total GDP growth

	Growth (yoy)						Contribution to growth					
	2010				2011		2010				2011	
	Q1	Q2	Q3	Q4	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2
Agriculture	3.00	3.08	1.80	3.35	3.44	3.74	0.42	0.43	0.26	0.39	0.47	0.51
Mining	3.12	4.01	2.83	4.34	4.35	0.83	0.26	0.33	0.23	0.36	0.35	0.07
Manufacturing	3.71	4.35	4.08	5.43	5.19	6.24	0.97	1.13	1.05	1.44	1.34	1.60
Electricity, Gas and Water Supply	8.18	4.66	3.16	5.16	5.25	4.60	0.06	0.04	0.02	0.04	0.04	0.04
Construction	7.05	6.93	6.42	6.82	5.57	7.74	0.45	0.44	0.41	0.46	0.36	0.49
Trade, Hotel & Restaurant	9.37	9.67	8.78	7.92	7.68	9.58	1.56	1.61	1.48	1.39	1.32	1.65
Transport and Communication	11.95	12.94	13.33	15.71	13.79	10.63	1.02	1.13	1.17	1.43	1.25	0.99
Financial	5.28	6.03	6.34	6.35	6.73	6.45	0.51	0.58	0.59	0.61	0.65	0.62
Services	4.62	5.25	6.44	7.66	7.08	5.76	0.44	0.50	0.59	0.73	0.66	0.55
Real GOP Growth	5.69	6.19	5.82	6.86	6.44	6.50	5.69	6.19	5.82	6.86	6.44	6.50

Source: CEIC Database

In contrast, trade, hotel and restaurant charted yearly growth at 9.6 percent in Q2-2011, after a slightly drop from 7.9 percent in Q4-2010 to 7.7 percent in Q1-2011. This sector contributed more than one-fifth and one-fourth of total GDP growth in Q1-2011 and Q2-2011, respectively. Moreover, transport and communication still recorded double-digit growth, despite its downward trend in recent quarter. The trans-

port and communication growth rate was 13.8 percent in Q1-2011 and 10.6 in Q4-2011, down from 15.7 percent in Q4-2010.

Among the industry sector, meanwhile, mining growth weakened, yet that of construction and manufacturing increased. Year-on-year growth in mining sector was 0.8 percent in Q1-2011, down from 3.4 percent in Q4-2010 and Q1-2011, respectively. On the contrary, annual growth of construction was 7.7 percent in Q2-2011, after falling from 6.8 percent in Q4-2010 to 5.6 percent in Q1-2011. Leading by the impressive expansion in iron and steel subsector, together with textiles and footwear subsectors, yearly manufacturing growth was 6.2 percent in Q2-2011, higher than 5.4 percent in Q4-2010 and 5.2 percent in Q1- 2011. The contribution of manufacture to total GDP growth also continued to rise from around 20 percent in Q4-2010 and Q1-2011 to nearly 25 percent in Q2-2011.The strong growth in manufacturing was supported by the still buoyant level of external demand and steady domestic demand.

Monetary Development

Inflation

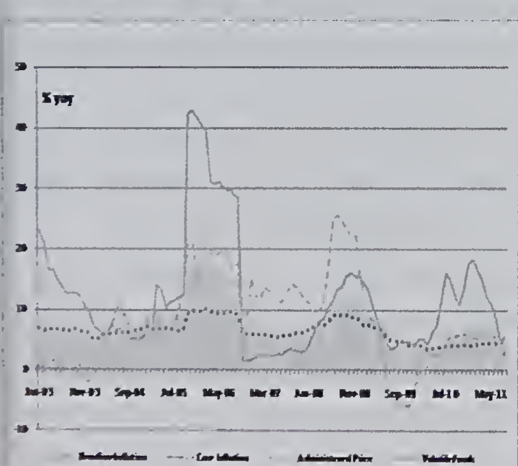
Up to August 2011, the inflationary pressure continued to ease for seven consecutive months in 2011, led by the falling in volatile food prices. On a yearly basis, Indonesia's headline inflation continued to decline to 4.79 percent in August 2011 from its early peak of 7.02 percent in January 2011 (Figure 3a). Just as in the run-up in inflation starting since the second half of 2011, the volatile food prices drove the fall in the annual headline inflation rate in the last seven months of 2011 (Figure 3b). As red chilies, rice, and sugar prices slid, the price of volatile food prices significantly dropped to 5.07 percent in July from its peak level of 18.25 percent in January 2011, before slightly increased again to 5.64 percent in August 2011 due to surging demand in fasting month and the *Idul Fitri* festivities.

Moreover, the core inflation gradually increased in the first eight months of 2011, while the administrated prices remained relatively mild. The core inflation gradually increased to 5.15 percent in August 2011 from 4.18 percent in January 2011, reflecting the pass-through of international and domestic commodity prices or the potential emer-

gence of capacity constraints (Figure 3a). Meanwhile, the administered prices in general slightly increased from 5.21 percent in January 2011 to 5.61 percent in July 2011, before slowing down again to 2.61 percent (Figure 3a). The relatively milder administered prices in 2011 were due to the absence of government decisions in the fuel price policy and other strategic items. The increase in administered prices was mainly contributed by an increase in the cigarettes and water billing rates, off-setting the deflation in rail fares following fare cuts for electric commuter trains in the Jabotabek area.

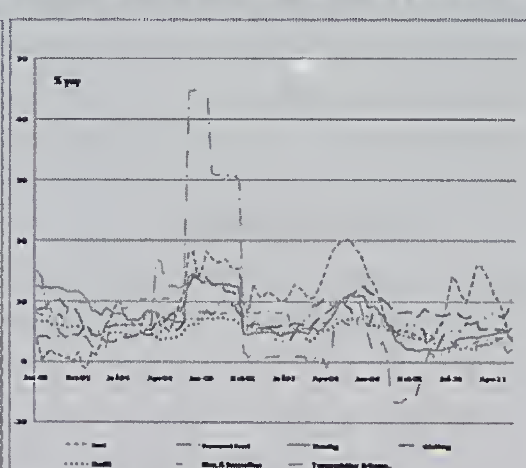
All in all, the Indonesia's yearly inflation rate reached an average of 5.9 percent (yoy) and cumulative January-August inflation touched 2.7 percent (ytd). This is still lower than government target 6.3 percent in national budget and expected to stand well within the 4 to 6 percent of Indonesia central bank target range. Looking ahead, the inflation rate is expected to remain under control if no change is made in the government fuel price policy and if food supply and distribution are maintained. Moreover, the core inflation is also expected not to exceed 5 percent this year, as rupiah appreciates and the effect of international commodity prices continues to ease.

Figure 3a: Inflation



Source: CEIC Database

Figure 3b: CPI Inflation component



Source: CEIC Database

Monetary Policy and Interest Rates

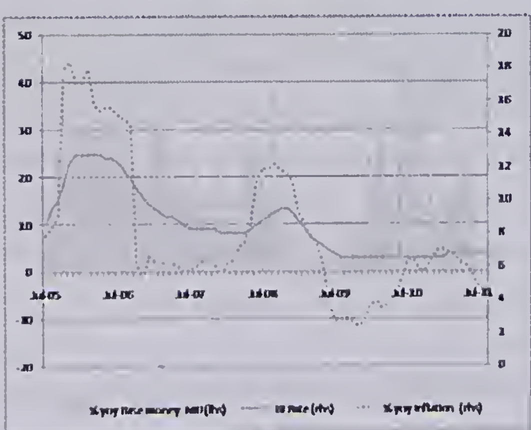
Until September 2011, Bank Indonesia (BI) left the monetary policy interest rate, BI rate, unchanged for the last seven consecutive months, in a bid to spur economic growth amid stable inflation and strong ru-

piah (Figure 4a). Since the 25 basis point rise in February, BI rate was stable at 6.75 percent. The current level of benchmark rate is perceived as being in line with the BI's efforts to support economic activities and stability in the midst of high domestic excess liquidity and persistent foreign capital inflows.

Looking forward, the latest BI's announcement indicated that BI rate would still be left at the current level of 6.75 percent until the end of 2011, as inflation estimated to be under control and could be lower than earlier expected if there is no government policy change in energy prices. BI will probably increase bank statutory reserves ration, instead of changing its interest rate policy. Furthermore, BI is expected to continue to implement the policy mix of monetary and macro-prudential measures, with focus on managing domestic liquidity, capital inflow, and rupiah exchange rate that is kept in line with movement of other currencies in Asia.

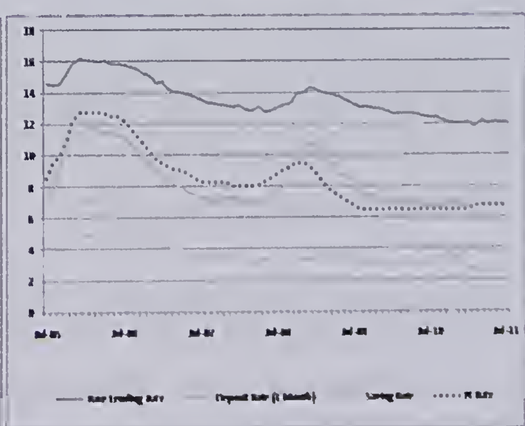
In line with the stable of BI's policy rate, meanwhile, private banks interest rate was also relatively stable, with milder fluctuation. During January to July 2011, based lending rate fluctuated around 11.82 percent to 12.18 percent, while the deposit rate hovered 6.72 percent to 6.86 percent (Figure 4b). Following a significant decline 0.14 percentages point to 2.56 percent in the first four months of 2011, the saving rates gradually rose again to 2.64 percent in June, before tumbling down to 2.52 percent in July

Figure 4a: Inflation, base money growth, and BI rate



Source: CEIC Database

Figure 4b: Policy rates, deposit rates, saving rates and lending rates



Source: CEIC Database

Balance of Payment

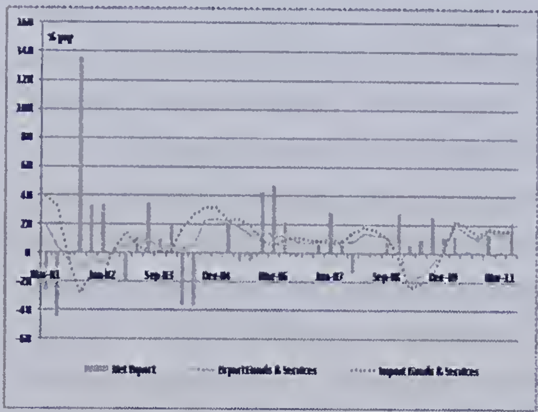
Exports and import

Export remained buoyant in the first half of 2011, in line with the rising volume of world trade and underpinned by increase in International commodities prices. After declined from 20.8 percent in Q4-2010 to 9.4 percent in Q1-2011, Indonesia real export growth bounced back again in Q2-2011, increasing by 12.6 percent (Figure 5a). Consistent with the increasing trend in exports and domestic demand, Indonesia's imports also expanded in the first seven months of 2011. In the real term, import grew by 12.2 percent in Q2-2011, following a significant decline from 19.7 percent in Q4-2010 to 9.4 percent in Q1-2011 (Figure 5a).

On nominal basis,. Indonesia recorded the biggest export value in history (US$18.4 billion) in June, before declining to US$17.4 billion in July. Cumulatively, Indonesia's export values in January-July period reached US$116 billion, an increase of 36.5 percent from the same period in 2010 . Meanwhile, the average annual growth of monthly import grew by 32.1 percent (yoy) in the period of January-July 2011, led by higher oil/gas import caused by the absences of government policy changes to increase the fuel prices, as well as strong import in raw material/intermediaries inputs for industry, particularly from electronics, machinery and iron and steel. Up to July 2011, Indonesia's year-to-date imports reached US$99.6 billion, an increase of 31.9 percent from that of January-July 2010.

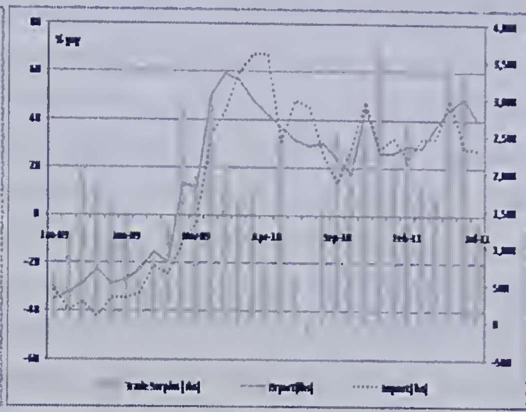
While Indonesia continued to experience positive trade balance in nominal term during the first seven months of 2011, the nominal trade surplus narrowed recently as monthly imports growth outpaced that of exports. During the period of December 2010- July 2011, the average nominal monthly export grew by 2.8 percent (mom), lower than that of import that expanded by 3.2 percent (mom). Indonesia trade surplus continued to decline from US$ 3.7 billion in December 2010 to US$ 1.4 billion in July 2011. Cumulatively, Indonesia experienced trade surplus of US$16.4 billion in January-July 2011.

Figure 5a: Real trade growth-National account exports and imports



Source: CEIC Database

Figure 5b: Nominal trade growth-Merchandise exports and imports



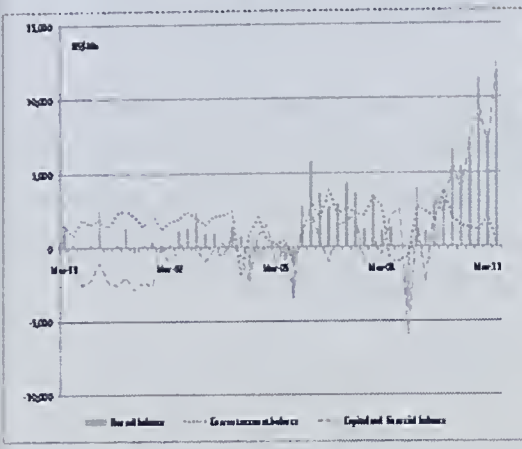
Source: CEIC Database

Current, Capital and Financial Account

Until the first half of 2011, Indonesia's overall balance of payment continued buoyant, supporting by strong increase in the surplus of capital and financial account that compensated the deteriorating surplus in current account. After declining from US$11.3 billion in Q4-2010 to US$7.7 billion in Q1-2011, the overall balance of payment surplus jumped back to US$ 11.9 billion (Figure 5a). The strong surplus in overall balances was mainly driven by sizeable surplus in capital and financial account exceeding the narrowing surplus in trade Account. After increasing by almost double to US$2.1 billion between Q4-2010 and Q1-2011, the surplus of current account in Q2-2011 declined to US$232 million. In contrast, the capital and financial account surplus increased by almost double from US$6.4 billion in Q1-2011 to US$12.6 billion in Q2-2011.

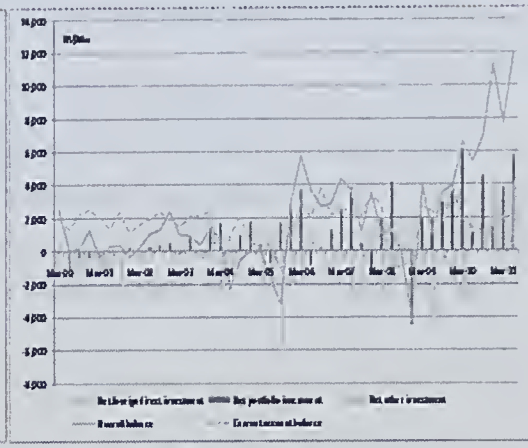
The positive outlook for the domestic economy together with a sizeable interest rate differential have encouraged foreign investors to continue channeling their funds into Indonesia, most importantly through portfolio investments in Indonesia government bonds and stocks. The net portfolio investment reached US$5.7 billion, up from US$1.4 billion in Q4-2010 and US$3.8 billion Q1-2011 (Figure 6b). On contrary, net FDI inflow moderated to 2.7 billion in Q2-2011 from US$4.2 billion in Q4-2010 and US$3 billion in Q1-2011.

Figure 6a: Current, Capital and Financial Account



Source: CEIC Database

Figure 6b: Financial Account Components



Source: CEIC Database

Money Market and Capital Market

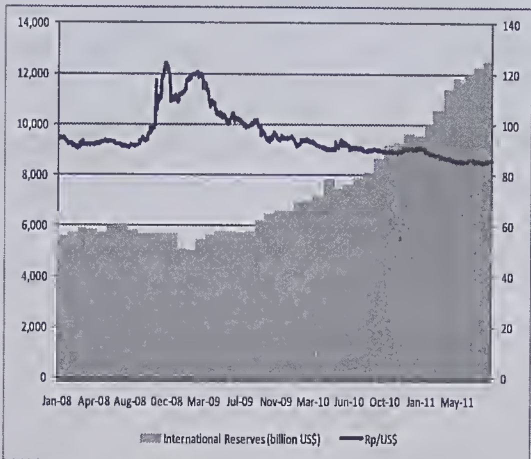
Rapid influx of foreign funds to Indonesia increased Indonesia's international reserves and created upward pressure on the local currency, before tumbling down again due to foreign capital reversal in recent days. Since early January 2011, rupiah has appreciated by more than 6 percent to its highest level in a year at Rp 8,460/US$ in early August (Figure 7a). In the same vein, during January-August 2011 the international reserves were buoyant, increasing from US$95.3 billion to US$124.6 billion (Figure 7a). Recently, however, rupiah was under downward pressure again as concern over European debt crisis is worsening and signs of slowing global growth reduced investor appetite for emerging-market assets. After hit its highest level in early August, rupiah depreciated again by more than 6 percent to Rp8,988/US$ in September 2011, totally offsetting the earlier appreciation (Figure 7a).

Driving by the movement of foreign capital, similarly, the domestic stock market was also initially under the upward trend in the first eight month of 2011, before falling down again in recent days. The Indonesian Composite Index (IDX) has hit its new all-time record of nearly 4,200 in early August, increasing by 12.5 percent since the beginning of the year (Figure 7b). However, negative external sentiment, involving the downgrading of ratings for some countries, fear over the spillover in debt crisis to Italy and uncertainty over the debt limit in

the US, caused rapid decreased in IDX. Recently, the IDX was at 3,369 in September 22, 2011, down by nearly 25 percent from its highest level in a year or 10.6 percent from its initial level in the beginning of 2011. (Figure 7b)

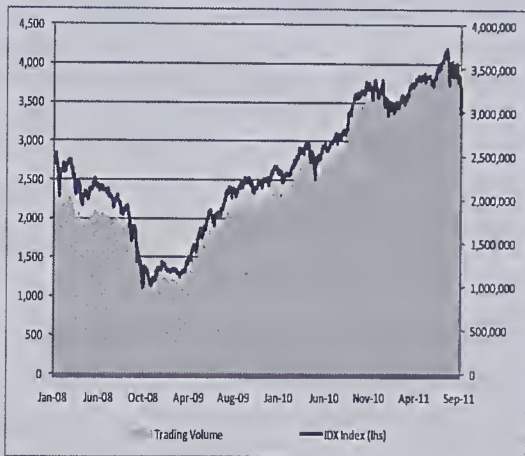
Ahead, the increasing risks of global uncertainty are expected to create downward pressures to rupiah and IDX in the short-term. However, the strong domestic economic fundamentals, such as reflecting on robust growth prospect and stable inflation, are expected to support strong IDX and rupiah appreciation in the longer term.

Figure 7a: Foreign exchange rates and official reserves



Source: CEIC Database

Figure 7b: Indonesian stock composite index and trading value



Source: CEIC Database

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